



**Department of Foreign Affairs & Trade**

**Internal Audit Report**

**Accommodation Expenditure**

**FINAL**

**Evaluation and Audit Unit  
September 2012**

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## EXECUTIVE SUMMARY

### Objectives and Scope of the Review

The Secretary General commissioned an audit of Departmental accommodation expenditure in early 2010, to be undertaken as part of the internal audit work programme for the year, with a view to strengthening internal control systems and achieving greater value for money. The audit was undertaken by the Department's Evaluation and Audit Unit; the fieldwork was outsourced to an external provider of internal audit services and was primarily carried out during the period October 2010 to May 2011.

The objectives of this audit assignment were:

- To assess the effectiveness of the system of internal controls over the Department's accommodation expenditure (i.e. property acquisition and disposal, major refurbishment and minor maintenance) in order to ensure that controls are adequate and adhered to and that value for money is obtained.
- To identify areas where greater efficiency can be achieved in terms of maintenance and management of accommodation.

The scope of the audit review was to assess the management of the overall risk environment in relation to A6 expenditures – with particular focus on major refurbishment projects – and the operation of the Department's Architectural Services Unit.

The audit examined projects that were undertaken in the period 2007-2010, which account for expenditure of some €20 million, or about 15% of total A6 expenditure over these years.

### Background

The Department has an extensive portfolio of official properties abroad – owned and leased – which are key infrastructure to support its diplomatic network. These properties represent chanceries and official residences and a significant proportion of the premises have been in the possession of the State for many years. Inevitably, major refurbishment projects, and other smaller maintenance works, have been necessary to maintain these properties in functional order.

At the end of 2010, the Department owned 36 properties overseas which have an estimated valuation in the region of €156 million<sup>1</sup>. A further 110 overseas properties are rented, with an annual rental expenditure of €16 million. The Department also occupies some 10 properties in the State, and 3 in Northern Ireland.

Accommodation expenditure is charged to the A6 Subhead and represents a significant expense. In the period under review, the total expenditure incurred under both Votes<sup>2</sup> amounted to:

	<u>€ million</u>
2007	35.5
2008	37.9
2009	34.8
2010	31.3

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<sup>1</sup> 2010 Appropriation Accounts for Votes 28 and 29.

<sup>2</sup> 2007-2010 Appropriation Accounts for Votes 28 and 29. From 2012, Vote 29 has been renamed as Vote 27.

The role of the Architectural Services Unit is to meet the accommodation requirements of the Department at all of the locations above. In this it supports mission staff in dealing with accommodation issues that arise overseas, and liaises with the OPW in the management and maintenance of the properties in the State. It has always been the policy of the Department that official properties abroad should present a positive image of Ireland as well as showcasing Irish art and furnishings, where possible. The audit wishes to acknowledge this commitment to quality that the Department and the Architectural Services Unit has endeavoured to achieve in the various projects delivered over the years.

In this regard, the primary responsibility of the Architectural Services Unit is to provide expert architectural support in the identification of needs for acquisition and renovation of properties, and in the prioritisation of these projects. On commencement, the Architectural Services Unit's role is to provide expert support in the management of the projects and in dealing with issues arising.

The Architectural Services Unit has to date been the budget holder for the costs of purchase and major refurbishment of overseas properties, and as such is required to provide written sanction for all amounts paid out overseas that are charged to the central A6 subhead.

At the time of the review, the Architectural Services Unit had 14 staff based in Dublin, comprising two architects, including the Director of Architectural Services, and 12 support staff.

## **Principal Issues Arising and Recommendations**

### **1. Project Management Accountability - Issues**

In order to ensure accountability in project management, the following criteria should be met.

1. Absolute clarity of roles, responsibilities and authority
2. A commitment to deliver these roles, supported by:
  - A system of rewards and sanctions
  - Removal of conflicts of interest
3. A requirement to report back on how the responsibilities are discharged
4. Recipients of these reports must challenge their contents
5. Potential for objective verification of the validity of these reports.

This review (section 1 of the main report) has identified issues that impact on the level of accountability, notably:

#### **Inconsistent Evidence of Project Authorisation & Subsequent Changes**

The Director of Architectural Services had an important role throughout the decision-making process as to scope and necessity of projects, and in assessing the appropriateness of project budgets. There is also evidence in some of the projects reviewed of an appropriate level of involvement at Secretary General and Head of Corporate Services levels in the original authorisation process.

In cases where the audit found no documented evidence of authorisation, we have been informed by Architectural Services that projects were authorised verbally at meetings chaired by the Head of Corporate Services.

The final costs of some major refurbishment projects have been considerably higher than the original budgets, principally due to scope changes during the course of projects. There has been inadequate documentary evidence of involvement beyond Architectural Services Unit level in the authorisation of major variations and extras, which frequently added significant amounts to the original contract values.

During 2010, there was increased formalisation of the process for prioritisation of projects, with the Secretary General and Head of Corporate Services playing an active role. The audit noted that more complete information listing all projects under consideration was by then being summarised for the Secretary General's information and decision.

### **Inconsistent Documentation of Procurement on Projects**

In almost all the cases reviewed, a tendering process has been carried out for selection of major contractors and suppliers.

However in every case the later stages of the selection process are not clearly documented, i.e.:

- Selection criteria and tenderers' scoring against these criteria
- Process not minuted
- Insufficient evidence as to who made the final decision.

In one case, a contract over the EU threshold of €135,000 was awarded without a tender process, although the Architectural Services Unit referred the (sole) quotation in question to the OPW, who expressed the view that the cost was reasonable. Notwithstanding this endorsement, in our opinion, the Department contravened Directive 2004/18/EU insofar as an appropriate competitive process was not carried out (see Section 4.4.2 of the Report).

### **Risk Issues Potentially Impacting on Project Management of Major Refurbishment Projects**

The key role of on-site Project Manager at a mission is typically carried out by a local firm of architects, selected on the recommendation of the Director of Architectural Services. There are, however, issues that present risks to the effectiveness of the resulting project management, including:

- Where the local architect is likely to have also drawn up the project specifications, he may be conflicted where construction problems arise that should have been foreseen by him
- A risk that the local architect may be more aware of his relationship with the local contractors on site, rather than his foreign client
- A practice for the local architect's fees to be a percentage of construction costs, which risks him being more likely to support variations that increase costs
- Diplomatic officers and local mission staff generally have no previous experience in construction project management, and so are limited in their ability to identify or compensate for underperformance by the project manager.

The Architectural Services Unit seeks to mitigate these risks through the engagement and oversight of the Director of Architectural Services and/or the Assistant Architect in each project.

The value of an on-site Project Manager is reflected in the Addis Ababa chancery project which was delivered successfully and without any significant additions (Section 4.5).

## **Issues in Budget Administration & Accountability for Expenditure**

The Architectural Services Unit is the budget holder for the Subhead A6 cost codes that cover all premises' capital, major maintenance and related costs.

In practice, this centralisation of budgetary responsibility has resulted in considerable resources being spent at mission level and at the Architectural Services Unit in a process of "sanctioning" all individual transactions that are charged to these codes. Heads of Mission, as the customers for projects, do not have budgetary responsibility for project costs. We believe that the consequent loss of local accountability on their part for project costs is not appropriate in these circumstances.

### **Limited Management Information**

Financial management information regarding project costs is limited. There is no regular and relevant financial reporting on project costs or comparison against project budgets produced from the financial management system. The Architectural Services Unit is currently accountable as budget holder for all A6 capital and major maintenance costs but, without project financial reporting, its capacity to manage these projects is reduced.

At mission level, project costs are generally tracked on off-line spreadsheets. However, because these are not reconciled to actual costs per the financial management system/general ledger, there is a risk that management at all levels may be informed by inaccurate data.

### **Limited Central Oversight of Project Costs**

In addition to little visibility of overall project costs, there is limited review of individual transactions at a central level. In most cases the Architectural Services Unit provides sanction for an overall contract value (or subsequent change order value) and assuring that individual invoiced amounts are valid is carried out at mission level only.

The Finance Unit review of transaction files from each mission (on about 2 months' transactions per year) provides a reasonability review of the invoices and supporting authorisations. In the case of progress invoices relating to A6 projects (which comprise the bulk of project expenditure) the Finance Unit transaction review provides little assurance since progress invoices cannot be related to the sanctioned contract amounts.

## **2. Project Management Accountability – Recommendations**

We recommend significant changes to the project management systems in order to achieve greater accountability, as follows:

### **Strengthened Role for the Architectural Services Unit**

There should be a strengthened role for the Architectural Services Unit in the identification and prioritisation of all refurbishment and maintenance projects. We recommend that a structured programme of on-site assessments should be completed as soon as possible, as an important part of the prioritisation of projects to be funded from the much-reduced budget for the foreseeable future.

The Architectural Services Unit recommendations arising from these reviews should be a key element in a much strengthened project authorisation and scheduling process recommended in this report, designed to ensure as far as possible that essential works are identified and prioritised,

and non-essential work does not proceed. This issue is addressed further in section 2.1 of the main body of the report.

The Architectural Services Unit should have a stronger role in the renewal of all leases, and maintain a central record with comprehensive management information to benchmark rental costs and support a more proactive role in managing renewals (see section 3.1 of the main report).

### **A Central MAC Subcommittee to Oversee all Major Refurbishment Project Activity**

We recommend that a formal MAC Subcommittee should be set up, chaired by the Secretary General. Its meetings should also be attended by the Director of Architectural Services, and the Head of Finance, with a designated officer from the Finance Unit to provide cost reporting of projects and respond to the needs of the Subcommittee and the Architectural Services Unit for analysis of project costs.

This subcommittee would have an oversight role in: project scheduling, project authorisation, procurement, monitoring of project progress and costs, and any other issues requiring attention at a high level (e.g. renewal of certain leases). This recommendation is addressed in greater detail in section 2.2.

### **Decentralised Budgeting for all A6 Expenditures**

Ownership and accountability for expenditure, and hence value for money, will be improved by decentralising the entire mission-related A6 budget to the missions themselves.

The process for allocating and monitoring the project element of the A6 budget across the missions will be the key element in this. We are confident that our further recommendations, envisaging a MAC Subcommittee to oversee this, supported by the much improved management reporting, can achieve this objective.

The manner in which the revised arrangement will work is described in section 2.3 of the main report.

### **Strengthened Role for the Finance Function with Improved Financial Management and Accounting Support**

The issues that have been identified in this report point to the need to strengthen the Department's Finance function. A strengthened Finance function will address the weaknesses in project budgeting and forecasting, inadequate financial and management reporting, and failure to fully recover VAT/sales taxes by missions (addressed in Section 3 of the Executive Summary).

The Finance function should play an important role in ensuring that a sound internal control framework is in place. Finance will also be a key support to the work of the MAC subcommittee and ensuring that projects are properly scoped and costed, and delivered within budget (see also the next section and section 2.4 of the main report).

### **Improved Management Reporting**

The proposed MAC Subcommittee, the Architectural Services Unit and the missions need considerably enhanced management reporting.



We recommend that the Finance Unit should set up and maintain quality and prompt project cost reporting, with the authority and competence to work proactively with the senior staff at mission level and the Architectural Services Unit.

Project management reporting needs to be set up, which should identify a range of management accounting data relevant to the ongoing monitoring of projects' progress. This is detailed further in this report.

The Department also needs to improve its capability to generate ad-hoc financial reports from the financial management system. It is essential that budget holders at central and at mission levels can readily seek analyses of data to support review of expenditures; making use of the coding structures set up to benchmark costs of maintenance, energy, security, rentals, etc, and allow constructive cost comparisons across missions.

This recommendation is discussed in more detail in section 2.5 of the main report.

### **Appoint Dedicated Project Personnel to Major Projects**

In order to address the potential conflict of interest where the local architect acts as project manager, we recommend that consideration should be given, on a project-specific and cost/benefit basis, to the temporary appointment of an experienced person to a mission that is commencing a major or complex project. Such a project manager could be based in Dublin should there not be a need for a full-time post at the mission concerned, and could be assigned responsibility for more than one project if appropriate.

The objective of this additional staffing is to strengthen local project management and relieve the existing mission staff, who would otherwise face significantly increased project-related responsibilities in areas where they are likely to have no prior experience.

This recommendation is elaborated upon in section 2.6 of the main report.

## **3. Other Risk and Control Issues**

We have also identified other important risk and control issues and made recommendations as follows:

### **Proactive Management of Overseas Property Lease Renewals**

The annual rental cost of 110 chancery/official residence properties is some €16 million, which amounts to 60% of total A6 expenditure. On average some 15 leases are renewed each year.

Missions receive authorisation from the Architectural Services Unit in respect of all lease renewals, given after interaction as to the suitability and value for money of the new terms. However, detailed work in renewals and the process for seeking best value terms is subject to local workload, and can be compromised by, likely inexperience of mission staff in this area.

Since the conclusion of the audit work, the Architectural Services Unit has completed a spreadsheet which shows rental costs and renewal dates for each location. We have recommended that the spreadsheet should be further developed to strengthen the process for the renewal of leases, including the role of the Architectural Services Unit in the process (see section 3.1).

## **Completeness and Timeliness of Recovery of VAT and Sales Taxes**

The audit has found significant exceptions in the recovery of these taxes for some of the projects reviewed (Ottawa and The Hague). Based on the lack of central review by the Finance Unit and the deficiencies in local systems identified, there is unquestionably a risk that significant amounts of taxes go unrecovered, or their recovery is significantly delayed, across the organisation as a whole (section 3.2).

## **Formal Internal Audit Conclusion**

Our overall conclusion is that this audit has shown that the internal controls over the area under review provide **limited assurance**. This means that a lesser degree of reliance can be placed on the adequacy of the internal controls in operation to mitigate and/or manage the business risks to which the activity under review is subject.

The disclosure of some major issues indicates an increased level of control risk. Management action is required to address the issues reported, with increased managerial supervision and ongoing oversight to ensure that control risk is reduced to an acceptable level.

## **REPORT DETAIL**

### **1. Project Management Accountability - Issues**

In order to ensure accountability in project management, the following criteria should be met:

1. Absolute clarity of roles, responsibilities and authority
2. A commitment to deliver these roles, supported by:
  - A system of rewards and sanctions
  - Removal of conflicts of interest
3. A requirement to report back on how the responsibilities are discharged
4. Recipients of these reports must challenge their contents
5. Potential for objective verification of the validity of these reports.

This review has identified issues that impact on the achievement of accountability in each of these areas, and makes recommendations in Section 2 to address each of these. The recommendations are summarised in paragraph 2.8.

#### **1.1. Inconsistent Evidence of Project Authorisation and Subsequent Changes**

We have reviewed the project authorisation processes carried out in respect of major projects. In particular we assessed the following projects carried out in the period 2007-2010, and which in total account for expenditure of some €20 million, or about 15% of total A6 expenditure over these years.

- Ottawa Residence refurbishment
- The Hague Chancery & Residence refurbishments
- Brussels Permanent Representative Office relocation
- Prague Residence refurbishment
- Addis Ababa Chancery construction.

Broadly, we conclude from this review that the Director of Architectural Services had an important role throughout the decision-making process by advising on the scope and necessity of projects, and in assessing the appropriateness of project budgets. There is also evidence in some of the projects reviewed of an appropriate level of involvement at Secretary General and Head of Corporate Services level in the original authorisation process.

In cases where the audit found no documented evidence of authorisation, we have been informed by Architectural Services that projects were authorised verbally at meetings chaired by the Head of Corporate Services.

During 2010, there was increased formalisation of the process for prioritisation of projects, with the Secretary General and Head of Corporate Services playing a more active role. The audit noted that more complete information listing all projects under consideration was by then being summarised for the Secretary General's information and decision. This has improved the prioritisation and authorisation process, which should benefit further from implementation of the recommendations in this report.

The final costs of some projects have been considerably higher than the original budgets, principally due to scope changes during the course of projects or due to unanticipated events occurring. The Director of Architectural Services has had a key role in the agreement of changes

and the associated costs. However there is little evidence of involvement at a more senior level than the Director of Architectural Services in the authorisation of major variations and extras, which frequently added significant amounts to the original contract values.

In summary, the project authorisation and tracking process could have been carried out in a more transparent way as follows:

1. In the absence of criteria in support of decisions, it is not fully apparent how objectively the prioritisation of major projects was carried out, nor the annual capital and major maintenance budget allocated during the period under review.
2. Notwithstanding that unforeseen problems can be encountered in old buildings, some of the projects reviewed in this audit have dealt with maintenance and repair issues that ideally should have been identified earlier. It may have been possible to address these and other repair projects more economically had there been a more proactive process to identify and action maintenance needs across the whole portfolio.
3. There was inconsistent documentation of original authorisations and subsequent changes in scope and cost on projects. Without sight of such documentation, it is not possible for this audit to independently confirm that there has always been adequate and timely authorisation at all levels of projects' scope and costs.
4. There was no formally documented process for approval, beyond the level of Director of Architectural Services, of scope changes during projects (and the resulting cost increases) in advance of such works proceeding. The audit was informed that scope changes were, however, orally reported to the Head of Corporate Services (and/or the Secretary General) as part of routine reporting by the Director of Architectural Services.
5. Financial management information, showing costs on all the Department's capital and major maintenance projects in a timely and clear way, was not available. Some missions kept their own off-line analyses of costs, but these were used at mission level only and were not reconciled to actual costs (i.e. per the financial management system).

Notwithstanding the current national budgetary difficulties, there will likely continue to be a significant underlying volume of smaller renovation and maintenance projects, with an increased requirement for:

- Selection and scheduling of these projects, so that those that are most necessary are prioritised and allocated funds
- Timely and comprehensive management information on project expenditures, so that prompt decisions can be taken on scope variations and any reallocation of funds.

## **1.2. Inconsistent Documentation of Procurement on Projects**

In almost all the cases reviewed, a tendering process has been carried out for selection of major contractors and suppliers.

However, in every case the later stages of the selection process are not documented, i.e.:

- Selection criteria and tenderers' scoring against these criteria
- Process not minuted
- Insufficient evidence as to who made the decision.

The Architectural Services Unit informed the auditors that it is the missions' responsibility to draw up and maintain the procurement documentation. As this is where the process is carried out, we believe this makes sense. However, at least at The Hague and the Brussels Permanent Representation to the EU, the mission level staff were not aware of their specific responsibilities in this area.

### **1.3. Risk Issues Potentially Impacting on Project Management**

The Architectural Services Unit does not have the resources to directly manage overseas projects. Hence the key role of Project Manager is usually carried out by a local firm of architects, who are selected with input from the Director of Architectural Services. While by definition the local architects will generally have no previous track record with the Department, we believe that such a selection process can be effective in identifying an appropriate Project Manager.

However, there are issues that present risks to the effectiveness of the resulting project management, e.g.:

- Where the local architect is likely to have also drawn up the project specifications, he risks being conflicted where construction problems arise that could have been foreseen by him
- There is a risk that the local architect will be more aware of his relationship with the local contractors on site, rather than his client, which is a foreign government representation carrying out a once-off project and whose diplomatic officers are all transient
- The practice has been for the local architect's fees to be a percentage of construction costs, so there is at least a risk that the architect does not seek always to minimise costs, or will be more likely to support variations that increase costs
- Diplomatic officers and local mission staff generally have no previous experience in construction project management issues, and so could be limited in their ability to deal with the project-related issues that arise.

The Architectural Services Unit seeks to mitigate these risks through the engagement and oversight of the Director of Architectural Services or the Assistant Architect in each project.

### **1.4. Issues in Budget Administration and Accountability for Expenditure**

Currently, the Architectural Services Unit is the budget holder for the Subhead A6 cost codes that deal with all capital, major maintenance and related costs for the overseas premises.

Administratively, this results in considerable resources being spent at mission level and at the Architectural Services Unit in a process of "sanctioning" all individual transactions that are charged to these codes. In 2010, with a reduced level of activity, there were still 600 of these sanctions given, totalling €4.2 million. All of these required individual transmission of paperwork, review, resolution of queries, authorisation, communication of this, and recording in two central listings within the Architectural Services Unit. At year-end, there is a tedious follow up process to ensure that all sanctioned transactions are paid in the same year. Since the Missions are not the budget holders for these costs, the onus is on the Architectural Services Unit to follow up on this across the Department.

The missions, as the local customers for the project, do not have budgetary responsibility for project costs. We believe that the consequent loss of local accountability for project costs is not appropriate in these circumstances.

### 1.5. Limited Financial Management Information

A6 expenditure over the years 2007-2010 involved some 60,000 transactions over almost 100 locations. Easily accessed management information is essential in managing costs in this environment.

For example, during our review, we asked for a summary report in the format below, to summarise annual cost trends by mission, to be produced via the Department's "Vision" reporting software (which was installed as part of the financial management system to provide this level of reporting). However a report in this format could not be made available.

Format for Reporting by Mission																
Code	Mission	Year	A6 ARC/EN G	A6 CAPMAIN T	A6 CHANR ENT	A6 CHARG ES	A6 CLEANI NG	A6 ENERG Y	A6 FURN	A6 FURNM OVE	A6 MAINT	A6 MAJOR MNT	A6 MINOR	A6 SECURIT Y	A6 TEMPACC	TOTAL
M001	Berne	2007														
		2008														
		2009														
		2010														
etc etc.																
M058	Prague	2007														
		2008			129,651	30,661	7,474	16,215	2,121		12,119	12,634	3,741	1,530		218,146
		2009		198,154	145,386	29,830	9,055	18,404	58,626		18,371		2,829	1,279		481,934
		2010	2,859	524,518	123,737	24,146	7,085	15,124	212,082	6,022	12,298	2,532	1,098	1,127	25,786	958,414
etc etc.																
M088	Abu Dhabi	2007														
		2008														
		2009														
		2010														
Total All Missions		2007														
		2008														
		2009														
		2010														

Financial management information regarding project costs is extremely limited. There is no regular and relevant financial reporting on project costs or comparison against project budgets produced from the financial management system. Budget holders and higher-level management therefore lack this information. The Architectural Services Unit is currently accountable as budget holder for all A6 capital and major maintenance costs, but without project-level financial reporting its capacity to manage these projects is reduced.

At mission level, staff have in some cases tracked project costs locally using off-line spreadsheets. At The Hague, this was done by the architect/ project manager. At best, this is a diversion of scarce local management resources. At worst, since these analyses are not reconciled to actual costs per the financial management system/ general ledger, management may be informed by inaccurate data.

### 1.6. Limited Central Oversight of Project Costs

In addition to limited project cost visibility, as described in 1.5 above, there is limited review of individual transactions at a central level.

The Architectural Services Unit provides written sanction for agreed expenditures. A copy of the correspondence granting sanction is required to be attached to all the individual invoices that are paid. All the invoice documentation is kept at mission level. For some projects reviewed by the audit (e.g. Ottawa) the Architectural Services Unit was sent copies of the contractor's progress

invoices and sanctioned the payment of the individual transactions. However, in most cases the Architectural Services Unit provides sanction for an overall contract value (or subsequent change order value); in these cases responsibility for assuring that individual invoiced amounts are valid lies at mission level only.

Randomly during a year, the Finance Unit requests about two months' transaction files from each mission. There is a reasonability review carried out of the invoices and supporting authorisations. In the case of progress invoices relating to accommodation projects (which comprise the bulk of project expenditure) this review is unavoidably limited as progress invoices by their nature cannot be related to overall sanctioned contract amounts. Other than seeing that the mission staff have signed off on the payment, this review does not provide added assurance.

### **1.7. Limited Documentation of Policies and Procedures**

Chapter 1 of the Department's "Green Book" of administrative guidance for missions abroad addresses a series of instructions and guidelines in respect of Official Accommodation Overseas. These instructions date from 1993. While almost 20 years old, there are many principles included that continue to be very appropriate, e.g.:

- Selection criteria for accommodation
- Requirements re cost, location, quality
- Standards for furnishing
- Upkeep and maintenance
- Health and safety
- Security
- Insurance
- Recordkeeping and reporting requirements

The Department's practices in many of these areas have evolved over the years, for example in the areas of procurement and I.T. management and security. In other areas, such as recordkeeping and reporting as outlined in this report, compliance with the standards in Chapter 1 of the "Green Book" has become lax.

There are also other areas where policies and guidance must be updated to reflect the development in requirements since the 1990s. We make several recommendations in Section 2.7 of this report as to where updated guidance seems necessary.

## **2. Project Management Accountability – Recommendations**

We set out below organisational and reporting changes which we believe address all the issues in Section 1 above.

### **2.1. A Strengthened Role for the Architectural Services Unit**

#### **Prioritisation of All Refurbishment and Maintenance Projects**

We recommend a strengthened role for the Architectural Services Unit in the identification and prioritisation of all refurbishment and maintenance projects.

A previous report under the former Expenditure Review Initiative recommended a 7-year cycle of visits to all locations to assess accommodation and maintenance needs. We believe that it is necessary to go beyond this requirement. A structured programme of on-site expert architectural assessments, agreed by the MAC subcommittee, should be completed as soon as possible, as an important part of the prioritisation of projects to be funded from the much-reduced budget for the foreseeable future.

This should be an important element in achieving best value for money from the reduced budget, by ensuring that expenditure is targeted on the most essential works, and that any significant issues are identified before they become more costly to fix.

These assessments should in the first instance focus on locations where:

- Such visits have not been carried out recently
- Local management have indicated construction, repair or maintenance issues that they consider to be urgent
- The Architectural Services Unit is otherwise aware of issues, but needs better detail of scope
- Others have identified significant issues (e.g. during inspections).

The Architectural Services Unit recommendations arising from these reviews should be a key basis for the strengthened project authorisation and scheduling process recommended in this report, designed to ensure as far as possible that essential works are identified and prioritised, and non-essential work does not proceed.

#### **Update of Policies and Guidance re A6 Expenditures**

The Architectural Services Unit should take responsibility for updating Chapter 1 of the “Green Book” along the lines suggested in paragraph 2.7 below.

#### **Coordination of Lease Renewal Activity**

The Architectural Services Unit should have a more proactive role in the renewal of all leases, on the lines suggested in paragraph 3.1 below.

The central record recommended below should be maintained by the Architectural Services Unit, which should upskill staff as required to manage the database software used.



## 2.2. A Central MAC Subcommittee to oversee all Project Activity

We recommend that a formal MAC Subcommittee should be established:

- Chaired by the Secretary General
- With 2 other members, the Head of Corporate Services and another senior MAC member with ambassadorial experience
- All meetings being attended by the Head of Architectural Services, and the Head of Finance
- With a designated officer from the Finance Unit to provide cost reporting of projects and respond to the needs of the Subcommittee and the Architectural Services Unit for analysis of project costs.

The role of this Subcommittee would be:

### Project Scheduling

- Oversee and approve the prioritisation of all projects as recommended by the Head of Architectural Services
- Responsibility for the inclusion/ exclusion of projects where the Architectural Services Unit is unable to reach consensus with the missions involved
- Revisit the project schedule quarterly, agreeing as required which projects to add and which to remove from the schedule

### Project Authorisation

- Review and authorise the project scope and budgeted cost for projects over a certain value (e.g. €100,000)
  - Below this value may be authorised by the Head of Corporate Services (e.g. over €25,000)
  - Under this value authorised by the Director of Architectural Services alone
- Authorise the delegation of all project budgets to missions throughout the year
- Review and re-authorise the project scope and budgeted cost for projects where a cost overrun is forecast (e.g. overrun against original budget of 10%+)
  - Under this limit, overruns authorised by the Director of Architectural Services alone

### Procurement

- Define authority limits for the selection of contractors and suppliers
- Receive evidence of, and approve, the selection process for all individual contracts or purchase orders over a certain value (e.g. €50,000)

### Monitoring of Project Progress & Costs

- Be informed by the Director of Architectural Services on the operational progress of projects
- Review quarterly financial reports of project costs, overall and for major projects
- Query cost trends and forecasts
- Revisit individual project scope and schedules as necessary in response to cost overruns

### Other Issues

- Be informed by the Director of Architectural Services of other relevant issues
- Monitor the progress of the renegotiation of leases (see below)
- Initiate high level decisions on sale of properties etc.

### 2.3. Decentralised Budgeting for all Subhead A6 Expenditures

We recommend that ownership and accountability for expenditure, and hence value for money, will be improved by decentralising the project-related A6 budget to the missions. This will be in addition to the non-project budget that is already allocated to missions, the latter covering rentals, energy, minor maintenance, etc.

This will allow visibility of project costs at local level, which is currently not available. It will also deliver central efficiencies within the Architectural Services Unit; for example the payment sanction process can be discontinued, freeing resources for more value-added functions as recommended throughout this report.

The process for allocating the project element of the A6 budget across the missions will be the key element in this, supported by the much improved management reporting described below.

The annual budget for project expenditure would be allocated as follows:

- At the start of the year to each mission for the forecasted remaining costs on projects already in progress
- The balance of the annual budget being held at the centre pending approval of new projects
- As new projects are approved during the year, the project budgets are then allocated to the missions involved and deducted from the balance remaining at the centre.

In outline this would be as follows:

<u>Total A6 budget for the year</u>	<u>25,000,000</u>
<u>Initially allocated as:</u>	
1. To individual missions for recurrent costs, e.g. rent, utilities	20,000,000
2. To individual missions for forecasted costs on projects already in progress	1,000,000
3. Retained at centre pending authorisation of new projects	<u>4,000,000</u>
	<u>25,000,000</u>

During the year, the remaining €4,000,000 is allocated out to individual missions that have projects approved. (The allocated amount will be the amount of expenditure forecasted to occur in the current year only).

### 2.4. Strengthened Role for the Finance Function and Improved Financial Management and Accounting Support

The issues that have been identified in this report with regard to weaknesses in project budgeting and forecasting, inadequate financial and management reporting, failure to fully recover VAT/sales taxes by missions (see Sections on Ottawa and The Hague projects), point to the need to considerably strengthen the Department's Finance function. The Finance function should play an important role in ensuring that a sound internal control framework is in place.

The Department's Audit Committee<sup>3</sup> has noted the very limited number of professionally qualified accountants employed in finance roles, with none at key decision-making levels. The Audit Committee has expressed its concern with this situation given the pressures on budgets and

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<sup>3</sup> Annual reports of the Audit Committee since 2009

the need for heightened financial control and efficient use of resources. The Committee has recommended that the Head of Finance should be a professional accountant at Counsellor/ Principal Officer grade with significant relevant experience, and that this position be supported by qualified accountants with financial/ management accounting roles for each Vote.

We believe the issues raised and the recommendations made in this report strongly support the Audit Committee's recommendation, in that the Finance Unit would need to provide for:

- Greater use of decentralised budgets and ongoing allocation to missions
- The needs of the MAC Subcommittee in overseeing project activity, for:
  - Timely cost reporting against project and annual budgets
  - Analysis and challenge of projected costs
  - Assurance that contract costs are not exceeded
  - "Early warning" of project costs that may exceed budget
- Regular and ad-hoc project data tailored to the needs of central and mission-level management.

## 2.5. Improved Management Reporting

The proposed MAC Subcommittee, the budget holders and the Architectural Services Unit, need much enhanced management reporting. This must be regularly available on a project-by-project basis.

We believe that the Finance Unit should set up and maintain quality and prompt project cost reporting, i.e. regular reporting to senior management and quarterly to the MAC Subcommittee on project costs and forecast final costs, with budget comparisons in the format below. The staff carrying this out must have the authority and competence to work proactively with the senior staff at the missions and with the Architectural Services Unit.

Format for Quarterly Project Reporting - All Projects												
	Total Project Costs			Actual Costs				Annual Expenditure				
	Original Budget	Forecast Total Project	Variance %	Actual YTD	Actual Prior Years	Total Project To Date	% Complete	Actual Prior Years	Current Year Budget	Forecast Current Year	Forecast Year +1	Forecast Total Project
Project 1	1,100,000	1,150,000	5%	345,000	265,000	610,000	53%	265,000	600,000	600,000	285,000	1,150,000
Project 2	214,500	221,200	3%	135,250	0	135,250	60%	0	214,500	221,200	0	221,200
Project 3	75,000	75,000	0%	15,000		15,000	20%		75,000	75,000		75,000
Project 4	45,000	47,000	4%	2,000		2,000	4%		47,000	47,000		47,000
Project 5	32,000	28,000	-13%	5,000		5,000	18%		28,000	28,000		28,000
Unallocated Budget									3,035,500	3,028,800		
	1,466,500	1,521,200	4%	502,250	265,000	767,250	50%	265,000	4,000,000	4,000,000	285,000	1,521,200

This format summarises project costs for all projects in progress, and highlights:

- The unallocated budget for the year, which is the amount remaining at the centre that is yet to be allocated among projects that are not yet approved
- The project costs that are forecasted to occur in the current year ("Forecast Current Year") for assessment against the current year's budget
- The project costs that are forecasted to occur in the next year ("Forecast Year +1") which is a starting point for the following year's budgeting process.

This summary report will be derived from individual project reports, showing the delegated budget for each separate project. These are set up in the same format, ideally to be produced

monthly. These are intended primarily for use by the missions as budget holder for the project, and form the basis for discussions between the designated Finance officer and the missions regarding the continued accuracy of projected costs.

Format for Individual Project Reporting												
"Project 2"	Total Project Costs			Actual Costs				Annual Expenditure				
	Original Budget	Forecast Total Project	Variance %	Actual YTD	Actual Prior Years	Total Project To Date	% Complete	Actual Prior Years	Current Year Budget	Forecast Current Year	Forecast Year +1	Forecast Total Project
A6 ARC/ENG	7,500	7,500	0%	6,000		6,000	80%		7,500	7,500		7,500
A6 CAPMAINT	175,000	185,000	6%	125,000		125,000	68%		175,000	185,000		185,000
A6 FURN	15,000	12,000	-20%	750		750	6%		15,000	12,000		12,000
A6 FURNMOVE	2,500	2,500	0%	750		750	30%		2,500	2,500		2,500
A6 MAINT												0
A6 MAJORMNT												0
A6 TEMPACC	4,500	4,200	-7%	2,750		2,750	65%		4,500	4,200		4,200
												0
Contingency	10,000	10,000	0%	0		0	0%		10,000	10,000		10,000
	214,500	221,200	3%	135,250	0	135,250	61%	0	214,500	221,200	0	221,200

### Improve Capacity for Ad-Hoc Reporting of Costs

We recommend that the capacities of Finance Unit staff to generate financial reports from the financial management system be increased. It is essential that management can readily seek analyses of data to support reviews of expenditure, by making use of the coding structures set up to benchmark costs of maintenance, energy, security, rentals, etc. and allow constructive cost comparisons across missions.

### 2.6. Appoint Dedicated Project Personnel to Major Projects

While it is generally the practice to appoint a local firm of architects to act as Project Manager, we recommend that consideration be given, on a project-specific and cost/benefit basis, to the temporary deployment of an experienced person to be temporarily appointed to a mission that is commencing a major or complex project. Such a Project Manager could be based in Dublin should there not be a need for a full-time post at the mission concerned, and could be assigned responsibility for more than one project if feasible.

The objective of this additional staffing is to relieve the mission staff (who will otherwise face significantly increased responsibilities in areas where they are likely to have no prior experience) by:

- Acting as the primary point of contact between the local architect/ project manager, contractors and senior mission staff
- Attending at site meetings and dealing with local authorities, neighbours, etc.
- Assuring the validity of payments to contractors
- Liaising with the Head of Mission, the Architectural Services Unit, the MAC Subcommittee, and the central Finance Unit as recommended in this report.

Elsewhere in the Department, or in the wider Public Service, there may be officers who already have this experience, or who may be better equipped to carry out these functions than the existing mission staff. Alternatively, it may be possible to source a Project Manager externally on a temporary basis with the requisite qualifications, experience and skills.

## 2.7. Further Development of Policies and Procedures

We recommend that the standards contained in The Department's "Green Book" should be updated by the Coordination and Compliance Unit to reflect management's current expectations and changes in technology as necessary.

Additional subject material should be added in the premises management area, for example:

- Procurement policies, procedures and documentation
- Local IT infrastructure security, continuity and contingency planning
- Data security
- Premises fixed security – e.g. updated standards for access/layout, locks, alarms, detectors etc.
  - response to non-malicious incidents – fire etc.
  - response to malicious incidents – break-ins, vandalism, suspicious packages etc.
  - response to major incidents – evacuation etc.
- Security regarding people – e.g. use of guards, vetting of contractors etc coming onto the premises.

Specifically in respect of renovation projects, recognition should be given to the methodologies in the Department of Finance 2010 "Capital Works Management Framework". While in many cases designed for larger projects, this includes:

- Standard forms of construction contracts and associated model forms, dispute resolution rules, model invitations to tender, forms of tender and schedules
- Standard conditions of engagement for consultants, dispute resolution rules, model invitations to tender, forms of tender and schedules
- Standard templates to record cost planning and control information, and for suitability assessment
- Guidance notes covering the various activities in a project delivery process.

The review of standards should also address inclusion of the Department's "Standard Terms of Business" in accommodation-related contracts, making mandatory appropriate clauses regarding indemnification, confidentiality, and compliance with both local laws and the relevant EU regulations as to appropriateness of bidders.

Specifically regarding rented residential properties, a policy should be developed and disseminated that requires increases in rent and any other costs at all residential accommodation to be justified and authorised in writing. Based on the amount involved (i.e. the gross amount of additional rental or other costs to be spent) this should be authorised in accordance with the authorisation levels recommended for capital/ maintenance projects in this report.

## 2.8. Summary of Recommendations – Project Management Accountability

The recommendations above address the conditions for strengthening accountability in project management that were set out at the start of this section as follows:

Conditions for Accountability	Issues Arising in this Review	Recommended Changes
1. Absolute clarity of roles, responsibilities and authority.	<ul style="list-style-type: none"> <li>Authority levels for project decisions are not defined</li> <li>Responsibility for decisions is not always clearly recorded</li> </ul>	All authorisations of project scope, costs and subsequent changes to be subject to defined policies and authority levels and be consistently documented.
2. A commitment to deliver these roles, supported by: <ul style="list-style-type: none"> <li>A system of rewards and sanctions</li> <li>Removal of conflicts of interest.</li> </ul>	<p>The commitment to deliver may be reduced where:</p> <ul style="list-style-type: none"> <li>Budgetary responsibility does not lie with the decisionmaker</li> <li>Project management by local architects may be subject to conflicts of interest, including that fees are generally a percentage of final construction costs</li> </ul>	<p>Budgetary responsibility for project costs to be decentralised to Heads of Mission under specific parameters, subject to an ongoing budgetary and review process.</p> <p>Project progress and costs to be regularly assessed by a MAC Subcommittee.</p> <p>External advisors to be paid a fixed fee; performance incentives to be considered.</p> <p>Appoint dedicated project managers for larger projects at missions, who are not the local project architects.</p>
3. A requirement to report back on how the responsibilities are discharged.	Limited operational reporting	Finance Unit/ financial management system to deliver comprehensive reporting and assurance as to project budgets, current costs and projections.
4. The recipients of these reports must challenge their contents.	Little if any project cost or ad-hoc financial reporting	<p>MAC Subcommittee to receive regular reports on:</p> <ul style="list-style-type: none"> <li>Operational progress</li> <li>Financial progress and projections</li> </ul> <p>MAC Subcommittee to review and question facts and data reported, and ensure responses to queries arising.</p>
5. Potential for objective verification of the validity of these reports.		<p>Can be achieved by:</p> <ul style="list-style-type: none"> <li>Definitive assessment by the Finance Unit of the validity of project financial reporting and budgetary projections</li> <li>Post-project audits by Evaluation and Audit</li> </ul>

### **3. Other Risks and Controls - Issues and Recommendations**

#### **3.1. Management of Overseas Property Lease Renewals**

110 chancery/official residence properties are rented. The annual rental cost is some €16 million, which is 60% of total A6 expenditure. Assuming an overall average lease term of 5-10 years, this implies that perhaps 15 leases are renewed annually.

Missions must receive authorisation from the Architectural Services Unit in respect of all lease renewals. This authorisation is given after interaction with the mission as to the suitability and value for money of the new terms.

The detailed work in renewals and the process for seeking best value terms are managed locally by each mission. Therefore addressing this process properly is subject to local workload and can be compromised by mission staff's likely inexperience in this area. The key to maximising value for money is to approach the local landlord well in advance of the renewal date, to know the local market trends, and to have realistic alternatives established to improve the negotiating position.

The Architectural Services Unit has recognised this issue, and at the time of this audit review was compiling a record of all overseas lease data. Since the completion of the audit, the Architectural Services unit has completed a spreadsheet which shows rental costs and renewal dates for each location. With some enhancement, this spreadsheet can strengthen the management of the leased property portfolio (e.g. calculation and comparison of costs per m<sup>2</sup> of floorspace).

We conclude that there is scope for strengthening the management of rental costs in order to achieve greater value for money.

#### **Recommendations**

We recommend that the Architectural Services Unit should have a more active role in the renewal of leases, to include all of the following:

- Formally notify missions of upcoming lease expiry, at least 12 months in advance
- Liaise with missions to ensure that there are realistic options available in good time before the existing landlord is approached to negotiate renewal terms, e.g.
  - Assess the viable alternatives available, e.g. renew or move elsewhere
  - Employ local expertise on the rental market.

We also recommend that the central lease record be enhanced to provide all the management information that is required to benchmark rental costs and to support a proactive role in managing renewals, i.e.

#### **Central Database of Lease Terms**

##### Landlord Details

Name & contact details

Whether an individual, property company, pension fund etc.

##### Lease details

Inception date

Termination date

Lease term

#### Rental Costs

Annual rent cost, estimated escalation through end of current lease

Floor space, rental cost per sq mtr

Number of embassy staff, number of rooms/ sq metre usable space per person

#### Other Costs

Estimate of annual maintenance costs under lease terms

Estimate of "dilapidation" cost if included in lease contract

Estimate of relocation cost to other premises

Other benchmarks for official accommodation are given in the 1993 "Green Book" which should be revisited and included where useful.

### **3.2. Issues Regarding VAT and Sales Taxes**

#### **3.2.1. Completeness and Timeliness of Recovery of VAT and Sales Taxes.**

The diplomatic status of missions typically exempts purchases from VAT / sales taxes. The exemption operates in two ways: invoices from suppliers are zero-rated or VAT and sales taxes that are added to suppliers' invoices are refundable to the mission via claim to the local Revenue authorities.

Where VAT/sales taxes must be recouped from the local Revenue authorities, the Department is dependent on its missions to have local checking processes in place to ensure that all tax refunds are claimed, and once claimed, are received. There is no independent assessment, or reasonability review, as to whether amounts received represent all the taxes that are recoverable.

The audit found significant exceptions in each of the 3 missions where recovery of VAT was reviewed:

- Canada (€135,000 unrecovered from 2009; ref. paragraph 4.1.4 below)
- The Netherlands (€865,000 under-recovered through 2009; most but not all recovered since; ref. paragraph 4.2.8)
- Czech Republic (€35,000 unrecovered, ref. paragraph 4.4.4).

Based on the lack of independent assessment and the deficiencies in local systems identified, there is a risk that significant amounts of taxes go unrecovered across the organisation as a whole.

We believe the outcome of this audit shows that procedures to ensure the recovery of these amounts must be significantly improved, with a more visible role in particular for the Finance Unit in monitoring VAT and Sales Tax recovery. Our recommendations are set out in Section 3.2.3.

#### **3.2.2. Accounting for VAT and Sales Taxes.**

These taxes have comprised a significant part of the project costs reviewed in this audit. For example, VAT is charged in the Netherlands at a rate of 19% on construction costs.

The Vote 28 project costs shown under A6 are accounted for inclusive of these taxes, despite the amounts being refundable to the Department. The accounting policy in Vote 28 is for the refunds to be credited to Appropriation-in-Aid, rather than to the A6 costs. This significantly overstates



the reported costs of projects, and costs in general, and for this reason seems an inappropriate way of accounting for these.

Also, because of this accounting policy, VAT/ sales taxes recoverable are not part of the local mission's budget. We believe that the resulting loss of local accountability reduces the incentive to recover the amounts due and undoubtedly contributes to the significant exceptions and delays in recovery disclosed by this audit.

The Vote 27 accounting policy is different. Costs are charged to A6 nett of VAT, with the related VAT charged to Subhead A3. However the recovery of VAT is also credited to Appropriation-in-Aid, so resulting in the same loss of accountability at local level.

### **3.2.3. Recommendations**

#### **Seek an Up-Front Exemption**

The ideal solution is to obtain a VAT/sales tax exemption that would enable invoices to be zero-rated. This means that the VAT is not paid out and no further work is required. We acknowledge that these arrangements are agreed on a reciprocal basis, but nevertheless recommend that the possibility of obtaining a VAT exemption that provides for zero-rating of suppliers invoices, should be followed up with the local Revenue authorities by other missions, where relevant.

#### **Account on an Accruals Basis; Mission-Level Budget Responsibility**

Where exemption cannot be obtained, the way to have proper visibility across the organisation of the recovery of these taxes is to account for these in the missions' general ledgers on an accruals basis, as happens in private sector organisations that are registered for VAT. In this methodology:

- Invoices would be coded to charge the expense subhead with the nett amount
- A balance sheet account at each mission would be charged with the tax on each invoice
- This balance sheet account would be credited with the periodic refunds received from the local Revenue
- The balance on this account will then transparently show the amount of taxes unrefunded.

To report monthly costs on a cash basis, the balance on the balance sheet account must be expensed. For simplicity, this could be charged in one amount to a single subhead. This will distort the costs on this subhead somewhat, though only to a small degree if tax refunds are received in a timely way. There could be a single year-end exercise to allocate the balance across the correct subheads, if material unrecovered amounts are involved.

Alternatively, VAT recoverable should be a budget line item for missions. The amounts recoverable are as "budgetable" as the costs to which they relate.

Either methodology should be a practical and effective method of providing a consistent accounting policy across the two Votes, ensuring adequate visibility for the tax recovery process at each mission, and allowing periodic central review by the Finance Unit to ensure that the Department-wide policy is being addressed in a timely way.

## **Establish a Consistent Way of Tracking Recoveries at Local Level**

Individual monthly claims and recoveries must be managed at local level. There is no substitute for a detailed local checking process that matches the individual transactions claimed to those refunded. Where there are discrepancies, these must be immediately followed up.

## **Nett Recovered VAT and Sales Taxes against Subhead Costs**

The method recommended above of charging the nett amount of the invoice against the subhead, achieves the objective of stating costs more fairly, nett of taxes recovered.

## **Role of the Finance Unit**

The Finance Unit should play a more visible role in monitoring the accounting for and recovery of VAT/sales taxes by missions and ensuring that the balances not recovered at the year-end are minimised.

### **3.3. Inter-Vote Cost Recharges**

All A6 premises costs for DCD within Ireland (i.e. rental and upkeep of its Limerick and Hatch Street office space) are paid through the Vote 28 accounting system; the recharge is to allocate these costs to Vote 27.

The current recharge of costs from Vote 28 to Vote 27 is €1.348 million per annum, which is unchanged since calculated in 2007 based on the premises costs of DCD when it occupied the Bishop's Square offices in Dublin.

## **Recommendation**

To maintain the formality of an accurate charge to both Votes, we recommend that the basis of the charge be recalculated to reflect the costs of the Limerick and Hatch Street offices now occupied.

### **3.4. Custody of Title Deeds to Owned Properties**

Title deeds are essential documents that need to be maintained securely. Custody of deeds to properties owned by the Department is not managed by the Architectural Services Unit. The OPW has ownership of older buildings, but those acquired since 1988 are owned by the Department.

At the time of our audit review, the Department appeared not to have allocated responsibility for custody of deeds and the location of all these was not established.

Update: Since the conclusion of the audit, we have been informed by the Architectural Services Unit that they now have custody of all relevant title deeds.

### **3.5. Custody and Recordkeeping of Artworks**

The Department owns a significant portfolio of artwork, which is displayed at its properties worldwide. Also, several works are loaned from the National Gallery and Irish Museum of Modern Art (perhaps 5% of the overall total).

A monetary estimate of the value of these assets was not obtained by the audit, though this will probably be significant. Of course the value of the collection will go beyond its pure commercial worth.

The portfolio in Vote 28 funded missions is intended to be recorded in a central register maintained by the Architectural Services Unit. The artwork at embassies funded under Vote 29 is not documented in this register.

The Architectural Services Unit seeks to update the Vote 28 register every 2 years. At the time of our audit work, the last update was done in 2008. There are ongoing issues in getting the missions to provide timely and complete inventories of their artworks, which delays the update and causes the register to be incomplete.

Clearly, the lack of an up to date record of the location of artworks and the absence of procedures for independent verification of the continued existence of artworks at missions increases the risk of unidentified theft or loss.

During our review, we discussed how the management of the register and control over custody of artworks might be improved.

We also discussed availability of the necessary documentation to provide a record of the provenance of the most valuable items in the collection (i.e. through receipts, photographs, etc. to record the ownership and location history of each piece). There is no central process to maintain such a record.

## **Recommendations**

We make the following recommendations:

- The register should be set up on a mission-by-mission format (for both Votes)
- It should be a photographic record
- The latest version should be matched to the 2008 version and exceptions should be followed up
- Each mission should be given a copy of its part of the register, identifying the most significant items, so that senior mission staff can:
  - Be aware of the relative value of items in their custody
  - Decide on appropriately secure locations within the Chancery/ Residence buildings
  - Verify continuing existence and condition on an ongoing basis
- An annual return should be put in place where the Head of Mission confirms that all items in the register are present and that the register is complete for the mission
- A process for independent verification of items on hand should be set up (e.g. in conjunction with routine visits by the Architectural Services Unit, Inspection Department, Internal Audit, etc.).

Because this process will provide the missions with a local mission-based register that will be auditable, it will be reasonable to expect them to respond promptly with photos and descriptions of their items on hand.

In parallel to this, the provenance issue should be addressed, at least for the major owned works in the collection.

### 3.6. Custody and Recordkeeping of Inventories

The Architectural Services Unit also maintains a central register of the Department's inventories. The items comprising this register are listed in the Department's "Green Book" of administrative guidance for overseas missions. The Green Book also requires an annual update from each mission of the quantities of these items on hand.

At the time of our audit, a request to count and report inventory had been sent to missions by the Architectural Services Unit in February 2011, with the previous inventory requested in October 2009. Only some 60% of missions had responded to the 2009 request, despite reminders sent during the 12-month period following.

Overall, we believe the annual central exercise is of very little value as:

- 40% of missions do not respond at all
- For those that do, there is no means to compare the quantities on hand to what should have been there.

#### Recommendations

We recommend that the central monitoring of mission inventories be discontinued.

Instead, we recommend that the missions carry out regular local verification of existence of higher-value and more "portable" items, e.g. crystal, official china, cutlery, table linens, etc. Locally, the results of these counts should be assessed against senior mission staff's own knowledge of what quantities should be on hand.

Otherwise, larger items such as furniture, carpets, etc. should be recorded on a photographic register of each room's contents, and confirmation of continued existence be incorporated into the process recommended for artworks above, i.e.:

- An annual return where the Head of Mission confirms that all furniture items in their photographic register are present and that the register is complete for their mission
- A process for occasional independent verification of items on hand (e.g. in routine visits by the Architectural Services Unit, Inspection function, Internal Audit etc.).

## 4. Issues Arising on Specific Projects

### 4.1. Ottawa Residence Refurbishment

#### 4.1.1. Necessity and Value-for-Money of the Project

The renovation process began in mid-2006, when a local architect's report was commissioned that evaluated the house and site and identified the drawbacks in the existing structure as:

1. A congested internal plan that impacts on access to function rooms and the comfort of the occupants
2. Restricted access to the garden, which does not enhance the residence
3. Updating of some windows and HVAC systems required
4. Upgrade of some basic facilities required; kitchen, bathrooms, many fixtures and fittings
5. A need to carry out an audit of all systems within the house to ensure compliance with codes and to resolve those that do not
6. Evidence of dampness in the basement

While acknowledging these limitations, the architects nevertheless stated that while there was congestion in the layout that did not "maximise the potential of the site", the house was functional:

"...the home has successfully housed numerous ambassadors and their families over the years; originally often large families, but more recently in keeping with the demographics of the western world, housing professional couples with few or no children. ... In response to its dual roles for public and private realms, together with demands for tailoring to large and small groups, the house has had a number of renovations and additions over the years".

The architects set out 3 options to "maximise the inherent potential of the site".

Option 1. Update the existing building to address the basic maintenance issues 3-6 above and to freshen the external landscaping.

Cost estimated at Can\$ 500,000 – 1,000,000 (€300,000 – €600,000)

Option 2. Major update involving extensive demolition, renovation and addition to the rear of the house, to address all the layout and systems issues 1-6 above.

Cost estimated at Can\$ 2,000,000 – 4,000,000 (€1,250,000 – €2,500,000).

This was the option eventually proceeded with, though at an eventual comparable cost of some €5,400,000 (i.e. construction costs; excluding fees, fittings and temporary accommodation)

Option 3. Demolish and rebuild the entire house.

Cost estimated at Can\$ 4,000,000 – 10,000,000 (€2,500,000 – €6,250,000).

The original decisions as to the scope of the project and proceeding with the irrevocable demolition work were taken in 2007 and early 2008. At those times, it was far from apparent that

the budgetary issues that grew during 2008 would be so significant. Nevertheless, the rationale and justification for the option proceeded with is not clearly documented.

The valuation of the house and site in 2005 was €2.2 million. While the construction project will have increased the value of the property, it is unlikely to have increased this by an amount that is close to the final total of €6.4 million that was spent on the entire renovation project.

#### **4.1.2. Authorisation and Budget of the Project**

It is unclear what the authorised budget for the entire project was. While the Ambassador and the Director of Architectural Services were clearly much involved in the assessment of the local architect's options and the eventual selection of "Option 2", there is no documentary evidence of authorisation of the project specifics at a higher level prior to October 2008. Given the size of the project, a formal and documented authorisation process of all its stages should have been carried out prior to any site demolition work being undertaken, with clear approval given by the Secretary General.

The project was carried out in two phases, demolition and construction.

##### Demolition Phase

The demolition work proceeded in mid-2008, and ultimately cost up to €580,000, including related professional fees. During this phase, issues such as asbestos in the building were identified and resolved.

There is no evidence on file of a budget for the demolition work, or on whose final authority the decision to proceed was taken. This is significant not only in itself, but also because the major demolition work carried out meant that the further costs of reconstruction were inevitable. Again, there is no evidence on file of a total potential cost, or by whom this was assessed as part of the decision to proceed.

##### Construction Phase

Written authorisation for construction of the new layout was given by the then Secretary General on October 24th, 2008. The residence was by then unusable and the Ambassador had been living in rented accommodation since March 2008. The construction project could not have been cancelled or significantly cut down at this point.

The Secretary General's authorisation in 2008 was for a construction cost of €3,850,000 plus a 10% contingency, making €4,236,000. On the document submitted by the then Head of Corporate Services, the total cost of the project was indicated to be €5,236,000, being the construction cost of €4,236,000 plus €1,000,000 said to have been already committed in respect of fees and demolition.

In our view, only some €581,000 had been committed at that point in respect of demolition and related fees; the demolition itself was complete at a cost of €425,000. The total project cost and the remaining amount to be authorised at that time could respectively have been put at €5,547,000 and €4,966,000 as follows:

Estimated Budget as of October 2008	Incurred €'000	Remaining €'000	Total €'000	
Professional Fees	106	556	662	12.5% of construction cost
Demolition and garden	425		425	
Construction		3,850	3,850	
Contingency 10%		385	385	
Furniture & Fittings		125	125	= final actual costs
Temporary Accommodation	50	50	100	= final actual costs
	581	4,966	5,547	

There is no evidence that a final cost of this order was ever envisaged. As of March 2009, the Director of Architectural Services estimated the project budget at €4,700,000, being €4,000,000 for construction/ demolition and €700,000 for fees, with the project proceeding within this budget. As the demolition costs of €425,000 and the construction contract of €3,850,000 already totalled €4,275,000, a budget of €4,700,000 at this stage was already unrealistic.

#### Variations and Extras

During the course of the construction project in 2009, change orders (primarily internal layout changes to the original design) increased the construction contract by a further €1,085,000. The project manager/ local architect's fees on the change orders were an additional €135,000, and the cost of fittings and temporary accommodation (not previously included in any documented budget) came to €227,000.

The final outcome was:

	<u>Total Final Costs</u>		<u>Estimated</u>		
	<u>Can\$'000</u>	<u>€'000</u>	<u>Budget</u>	<u>Variance</u>	<u>%</u>
Professional Fees	1,375	860	662	198	30%
Demolition and garden	685	425	425		
Construction	7,799	4,935	3,850	700	17%
Contingency 10%			385		
Furniture & Fittings	200	125	125		
Temporary Accommodation	160	102	102		
	10,219	6,448	5,549	898	16%

The expenditure by year was:

	<u>2007</u>	<u>2008</u>	<u>2009</u>	<u>To Oct 2010</u>	<u>Total €'000</u>
Professional Fees	53	489	319		860
Demolition and garden		425			425
Construction		1,335	3,600		4,935
Furniture & Fittings			120	5	125
Temporary Accommodation		50	52		102
	53	2,298	4,091	5	6,448

The Architectural Services Unit was involved in the initiation of some of the change orders, and gave approval to those initiated locally, and also sanctioned payment of all the changes following certification by the local consultant architects that the work was done. However there is no evidence of authorisation at a higher level of the significant increase in cost.

We believe that there should have been evidenced high-level authorisation, prior to work commencing, of the change orders of over €1,000,000 that were added during the course of work in 2009.

#### Causes of the Higher than Expected Project Cost

It is unclear what the various stakeholders expected the final costs to be. However from the above one can conclude that the various factors that contributed to the final costs included:

- Absence of adequate project cost reporting, tracking budgeted and actual expenditures, with definitive projected final costs, to provide visibility of project financial data
- Understatement of projected final costs when forecast during the course of the project
- Exclusion from budgets of some costs, such as fittings and temporary accommodation, causing under budgeting of costs of some €250,000
- Significant change orders during the course of construction, primarily internal layout changes to the original design, increasing final costs by €1,220,000 (€1,085,000 plus 12.5% architect's fees).

#### **4.1.3. Advance Payments to the Contractor**

Written authorisation for construction of the new layout was given by the then Secretary General on October 24th, 2008. We have noted that in the two months between this date and the 23rd December, the contractor was paid some €1,335,000 on consecutively numbered invoices, representing 35% of the original contract value. Following this, the contractor did not bill for work done until June 23rd, 2009.

<u>Year</u>	<u>Period</u>		Payments €
2008	12	Invoice 2579	697,862.28
	12	Invoice 2580	317,316.32
	12	Invoice 2581	319,442.95
			<u>1,334,621.55</u>
2009	6		226,563.81
	7		314,197.63
	8		446,778.75
	9		470,914.33
	11		822,675.37
	12		<u>1,319,288.35</u>
			<u>3,600,418.24</u>
			<u>4,935,039.79</u>

We recognise that:

- Valid setup and mobilisation costs will have been incurred under the contract
- The winter period January – March will have had little construction work carried out
- The 2008 invoices were all evidenced as certified by the local architect/ project manager.

Nevertheless, the size of the payments made in late 2008 and the gap to the first payment in 2009 could suggest that the 2008 payments were accelerated to match a budget that was still available for that year. This year-end pressure to spend budgets is not uncommon and represents an unintended consequence of the annual cash-based budgeting system that is currently used across Government Departments.



#### 4.1.4. Non-Recovery of Sales Taxes

Sales taxes charged by suppliers are refundable to the Department. We reviewed the recovery of these during the period of major expenditures on the construction project. This review established, after considerable contact with the local mission staff, that as of February 2011 some Can\$ 181,000 (€135,000) remained unrefunded from 2009, as follows:

November 2009	\$ 68,659
December 2009	\$113,224

Most monthly claim amounts do not match to refunds received; it appears that other amounts from 2008/ 2009 are also unrecovered, though not of the size of those above.

The methodology of the Mission for ensuring that these taxes are recovered seems to have been non-systematic as:

- Refunds from the Canadian Revenue lag claims by about 3 months
- The Mission has difficulty in matching their monthly claims with the amounts eventually refunded
- It appears that the Revenue does not notify the Mission of discrepancies in claims and they withhold payment without any communication
- The Mission only carries out an annual comparison of total claims submitted with refunds received; and only if this annual exercise shows a big discrepancy is it queried with the Revenue.

The Embassy states that they had contacted the Revenue some months prior to our review to ask if any prior refunds had been withheld, but had not received any response until the time when our audit was in progress, and so had not yet re-sent backup paperwork to the Revenue to seek the outstanding amounts from 2009.

## 4.2. The Hague Chancery and Residence Renovations

### 4.2.1. Chancery Building - Scheveningen

The chancery building was purchased for €2 million in 2007 to replace the previous chancery in The Hague, which was considered by all concerned to be unsuitable for continued use both in layout and in condition.

The prior building was eventually sold in 2010 for €607,000.

### 4.2.2. Insolvency of Contractor and Legal Dispute

The new chancery building was originally a private residence and was later converted to office space. A tendering process was conducted by the consultant architects/ project managers "VMX" and a contractor "Systobouw" was appointed in July 2007 to remodel the interior of the building. Work began in August 2007 and was initially planned to be completed by July 2008, but this timetable was overrun due to unforeseen issues arising with the building and to additional work specified.

In October 2008, it was apparent to the project manager that work on site had slowed, and it was found that subcontractors had not been paid by Systobouw. At the same time, the Embassy was also contacted by the Dutch revenue who sought that future payments to Systobouw should be directed to the revenue in order to pay off Systobouw tax liabilities that were in arrears. The Embassy retained legal advisors to assist with the next steps.

Negotiations with Systobouw on the completion of the contract were unsatisfactory, and in November 2008 they were told that the contract was being ended. There followed disputes regarding access to the site, amounts withheld by the Embassy from Systobouw, and damages claimed by the Embassy against Systobouw for failure to meet its obligations. At the time of the audit, the position was that:

- In March 2009 the Embassy paid €150,000 to the Dutch revenue (being 50% of a €300,000 claim made by Systobouw against the Embassy)
- In January 2010 the Embassy lodged a claim against Systobouw for €838,000 to be heard in an arbitration process, representing the project manager's calculation of the additional costs incurred in the completion of the contract work at the chancery by two subsequent contractors ("Formabouw" and "Kuijpers").

Systobouw was declared bankrupt in October 2010 and a Receiver was appointed to the company. This led to the suspension of the arbitration process. The suspension was granted to allow the receiver time to decide whether he wanted to continue with the litigation.

#### Update 2012

We have been informed by the Embassy that it lodged a claim with the receiver for €838,000 in February 2011 and in March 2011 called in the €150,000 bank guarantee. In November 2011, the Receiver rejected the Embassy's claim and indicated that he was considering legal action over the recall of the €150,000 bank guarantee and other costs described as 'outstanding invoices'. The

possible counter-claim was estimated at €570,000. Given the low value of the assets of the company, it is most unlikely that the Embassy's claim would be successful.

The Embassy has been working with its legal advisers to bring this matter to a conclusion.

#### 4.2.3. Cost of the Project

In common with other projects, there are no project costs reported from the general ledger, and we have been unable to establish with any certainty a total project cost from the transaction files we have analysed as part of the audit. The total cost of €4.876 million used below (which is net of the proceeds of the sale of the old chancery of €0.607m) is as reported by the project manager VMX, from parallel records kept by the company.

The Hague Chancery - Scheveningen		
Estimated Project Costs		
	VAT-exclusive € million	
Purchase of new premises	2.000	
Sale of old premises	(0.607)	1.393
Original contract - Systobouw	1.489	
Adds to contract	0.516	
	2.005	
Of which paid to Systobouw - 59%		1.193
Contract to complete - Formabouw	1.273	
Adds to contract	0.093	
Contract to complete - Kuijpers	0.234	
Adds to contract	0.065	1.665
Fixtures & fittings		0.211
Professional fees (excluding legal)		0.414
Total estimated cost (excl VAT)		4.876
<u>% Extras/ adds to contract</u>		
Systobouw	35%	
Formabouw	7%	
Kuijpers	28%	
Professional fees % construction cost	14%	

The replacement of the original contractor mid-way through the project inevitably led to additional costs. In these circumstances any new contractor will charge more than the amount unpaid on the original contract. Overall, the claim of €838,000 made against Systobouw is an estimate of the increased costs incurred to complete the project.

However, we should also draw attention to the fact that the original contract was increased by 35% due to scope changes and extras. This is a high proportion and one that suggests that best value may not have been achieved in any case or that there were shortcomings in the original specifications, had the original contractor completed the project without interruption.

We believe that the failure of Systobouw could not have been predicted as part of the tender process, based on VMX's definite assertions that they were at the time a reputable contractor without any apparent financial problems.

#### 4.2.4. Residence – Wassenaar

In parallel with the chancery project, a major reconstruction of the interior of the residence was also commenced. The necessity for upgrade work had been flagged for some years, with structural issues regarding parts of the building needing to be addressed. A similar tendering process was conducted by VMX and a contractor “van Hoogevest” was appointed, which was a large and reputable firm with a good track record.

The project included extensive internal work including installation of an air conditioning system, also demolition of some parts of the building and construction of an extension which had to be partially underground, since the building was located in a conservation area with restrictions. Van Hoogevest handed over the building in late 2008, with the contract work apparently completed, at least to minor punch list level.

Van Hoogevest also declared bankruptcy at this time. Despite the building having been handed over, many faults then became apparent indicating poor workmanship in certain areas. From our discussions with VMX, they admit that their oversight of the work was lacking. A site management company they had hired also did not perform and failed to detect flaws in construction which subsequently caused significant leaking.

Another contractor, Formabouw, was taken on to deal with the many remediation issues, which included abandonment of part of the new basement as part of the resolution of the leakage problem.

The ongoing deficiencies in the residence building continued to the time of the audit (in this case, December 2010). These are summarised in a report of the Strategy and Performance Unit following an Inspection visit in October 2010. They include continuing dampness in the storage areas, leaks through parts of the structure, and heating and cooling problems throughout the building.

We believe that the failure of van Hoogevest also could not have been predicted as part of the tender process. At the time, it was a large reputable contractor whose demise was a surprise at national level in the Netherlands.

#### 4.2.5. Cost of the Project

As for the chancery project, there are no project costs reported from the general ledger, and we have been unable to establish a total project cost from the transaction files we have analysed as part of the audit. The estimates used below are as reported by the project manager VMX, from parallel records kept by the company.

The Hague Residence - Wassenaar		
Estimated Project Costs		
	VAT-exclusive € million	
Original contract - van Hoogevest	1.489	
Fixtures & fittings	0.141	
Demolition and gardens	0.063	1.693
Adds to contract	1.200	1.200
Total van Hoogevest & others		2.893
Contract to complete - Formabouw		0.220
Professional fees (excluding legal)		0.400
Total estimated cost (excl VAT)		3.513
<u>% Extras/ adds to contract</u>		
van Hoogevest & others	71%	

In this case, we believe the bankruptcy of the original contractor at “punch list” stage is unlikely to have caused significant additional costs. In fact the remedial work done by Formabouw is probably good value for money in the circumstances, as the original contractor would have had a conflict of interest in the identification and resolution of its own faulty work.

However, we draw attention to the fact that the original contract was increased by an exceptionally large 71% (€1.2m) due to scope changes and extras. This is inconsistent with achievement of best value.

We draw attention to the observation of the consultant architects who stated that “these additional works are mainly caused by the state of the existing building which became apparent after the first (demolition) works in the building. Also, additional fixed furniture, changes in the plan and the upgrading of the terrace have been part of the additional works and costs. Under the terrace a large additional basement has been created that was necessary since the existing building had not sufficient storage capacity”.

Internal works in an old building inevitably reveal unforeseen issues needing to be addressed. We believe the major internal and some external works proposed on a building in a heritage area with conservation requirements could have been less ambitious, or once designed not altered so extensively. In our on-site discussions with the architect/project manager VMX, they accepted this view.

#### 4.2.6. Organisational Issues

Having 2 major projects in progress at once was too difficult for the small number of senior local Embassy staff. While it is not obvious that the overstretch caused any of the problems that occurred, it is possible that this led to over-reliance on the project manager and less than critical assessment of his performance. There was some internal discussion in the Department on this issue, with the Director of Architectural Services expressing concern about the two projects running concurrently, but a decision was ultimately taken to proceed.

#### 4.2.7. Expenditure on Temporary Security

Our analysis of general ledger transactions noted a concentration of security costs in the period February/March 2008. This was caused by an expenditure of €51,700 on hired security companies in a 2-week period between December 25th 2007 and January 7th 2008.

There was an attempted break-in at the Wassenaar residence on the night of December 24th/25th, which had been aborted when the building's monitored alarm system rang. There had been no entry to the main part of the building, but a side door was open with damage to its lock. Embassy staff liaised with the local police who confirmed no entry had taken place. Embassy staff stayed at the residence for part of Christmas Day and the next night.

During the following 2 weeks, when the residence was unoccupied for the holiday period, a full-time 2-person security presence was put in place supplemented by 2 mobile surveillance patrols on a 24-hour basis, at the eventual cost of €51,700 referred to above.

The Architectural Services Unit has informed us that it is satisfied that this cost was justified.

We acknowledge that when any premises is temporarily unoccupied there is a risk of burglary, and when an attempt is made it is very disconcerting. However the residence's alarm system had been effective in deterring the burglary, and the local police were alerted so could be expected to have had at least some vigilance in the area in the following days. Therefore we question the proportionality of the security response and the major expenditure incurred.

#### 4.2.8. Delayed Recovery of VAT

VAT charged by suppliers is refundable to the Department by the Dutch revenue. The Mission provided an analysis of VAT claims and recoveries from the period when the main construction costs began (i.e. from Q4 2006). This shows significant under-recovery of VAT during this period, as follows:

The Hague - Recovery of VAT						
(Data as of February 16th, 2011)						
When Expended	VAT Amount	When Claimed	When Received	Refund Received	Balance Unrecovered	Of Which Overdue
Q4 2006	110,783	Q3 2009	Q4 2009		110,783	0
Q1 2007	66,521	Q3 2009	Q4 2009		177,304	110,783
Q2 2007	136,079	Q3 2009	Q4 2009		313,383	177,304
Q3 2007	54,572	Q4 2009	Q1 2010		367,955	313,383
Q4 2007	158,352	Q4 2009	Q1 2010		526,307	367,955
Q1 2008	182,266	Q4 2009	Q1 2010		708,573	526,307
Q2 2008	48,071	Q3 2010	Q4 2010		756,644	708,573
Q3 2008	60,295	Q3 2010	Q4 2010		816,939	756,644
Q4 2008	50,554	Q3 2010	Q4 2010		867,493	816,939
Q1 2009	27,285	Q3 2010	Q4 2010		894,778	867,493
Q2 2009	152,791	Q3 2010	Q4 2010		1,047,569	894,778
Q3 2009	131,208	Q3 2010			1,178,777	1,047,569
Q4 2009	88,338	Q3 2010		(313,383)	953,732	865,394
Q1 2010	25,955	Q4 2010			979,687	953,732
Q2 2010	7,878	Q4 2010		(395,190)	592,375	584,497
Q3 2010	17,474	Q1 2011			609,849	592,375
Q4 2010	27,397	Q1 2011		(338,996)	298,250	270,853
	1,345,819			(1,047,569)	298,250	270,853

Because the first claims for this period were not made for almost 3 years, from Q4 2006 to Q3 2009, by the end of Quarter 3 of 2009, €1.178 million in VAT was unrecovered, with €1.047 of this overdue (i.e. unrecovered for over 3 months). An explanation of the remaining unrecovered balance of €298,250 would require a detailed analysis beyond the scope of this audit.

## **4.3. Brussels – Relocation of the Permanent Representation Offices**

### **4.3.1. Formal Documentation of Supplier Selection Decisions**

In 2009, this office was moved from an OPW-owned building at 89/90 Rue Froissart to a rented building at 50 Rue Froissart. The Director of Head of Architectural Services advises that he questioned the value for money of the OPW decision to rent and not purchase the new building; however, they proceeded with the rental option.

From the documentation on file by the Architectural Services Unit, it is evident that a procurement tendering process was carried out for the selection of a contractor, Amart, to renovate the new building at 50 Rue Froissart (This contractor also worked at the Brussels Chancery building in 2009). Amart was paid €1.17 million and €0.33 million respectively on these projects. It is not clearly documented as to:

- What were the selection criteria and the various tenderers' scorings against these criteria
- The process carried out, via minutes or records of steps carried out
- Who carried out the evaluation process, and who made the final selection decisions.

As part of a parallel Internal Audit review at Brussels, staff based at the Permanent Representation stated they expected that the Architectural Services Unit maintained the "official" files with the record of the procurement process. Also, as sanction was given by the Architectural Services Unit for each stage payment, they assumed that all necessary records are kept by them. However the Architectural Services Unit sees responsibility for original documentation to be with the local mission, as it is there that the selection processes are carried out, local legal advice obtained, etc.

In our view it was unsatisfactory that there should have been this level of uncertainty as to responsibilities in this important area.

In response to the Internal Audit review at Brussels, management has already responded positively, as follows:

"Architectural Services, HQ, provides input to procurement projects abroad by way of professional expertise. However, the operational aspects, including maintenance of the primary records, are the responsibility of the relevant Mission. Corporate Service will review the guidelines it gives to Missions in this regard".



## **4.4. Prague Residence Refurbishment**

The audit noted that significant refurbishment works were undertaken at the Official residence in Prague during late 2009/early 2010, for which total expenditure amounted to over €1 million. This level of expenditure was not indicated in any internal documentation and we therefore added a review of the Prague project to our audit sample.

### **4.4.1. Development of the Project Cost**

A need for repainting interior walls and floors of the Residence was identified in mid-2009 by the Embassy. Some €24,000 was sanctioned for this work by the Architectural Services Unit on July 2nd 2009. Correspondence at this time also refers to a potential need to upgrade the basement to reflect the needs of the incoming ambassador, transferring from The Hague later in that year.

In relation to the basement work, we were informed that:

- Before work on the original contract started, clearing the basement area revealed extensive and major damp in the walls. The contractor was instructed by the Architectural Services Unit through the Embassy to engage an expert to assess the extent of the problem and a complete technical report including recommendations was submitted to and sanctioned by the Architectural Services Unit
- Other unforeseen problems emerged as the works progressed and the solutions proposed by the contractor were evaluated and sanctioned by the Architectural Services Unit.

Also in July 2009, "GP Design", the trade name of an interior design consultant from the Netherlands, was retained to advise on interior furnishings and fittings. GP Design charged €12,800 (excl VAT) for this work; this cost was paid by the mission in The Hague. This resulted in a proposal from another Dutch company "Ruys Interiors" (which was associated with GP Design) to supply interior furnishings at a cost of €186,000. Ultimately, payments to Ruys Interiors totalled €219,000.

By December 2009, expenditure sanctioned by the Architectural Services Unit totalled €680,000; approximately €450,000 for renovations and painting, and €230,000 for furnishings and fittings.

In February 2010, a significant leakage issue was discovered in the roof. This cost some €100,000 to correct. Other additions in 2010 to the scope of both internal and external works increased the ultimate cost of the project by a further €300,000 to a final total of some €1,050,000 - €1,100,000.

Detail and timing of the individual sanctions and monthly total disbursements are set out on the next page, indicating the piecemeal development of the contract scope.

Prague Residence - Timing of Sanctions & Expenditure							
When Sanctioned by Architectural Services Unit			Sanctioned Amounts			Monthly Expenditure	
			Main Contractor	Others	Cumulative to Date	Amount in €	Cumulative to Date
2009	July	Painting	23,984		23,984		
	November	Maintenance	129,655		153,639		
		Dampness treatment	22,740		176,379		
		Wooden cabinet		1,962	178,341		
		Safe		1,740	180,081		
		Furniture and fittings		186,068	366,149	88,820	88,820
	December	Refurbishments	6,330		372,479		
		Internal Works	169,202		541,681		
		External Painting & Decoration	102,612		644,293		
		Garden furniture & curtains		19,593	663,886		
		Carpet		10,500	674,386		
		TVs/DVDs		6,130	680,516	167,960	256,780
2010	January	Fixtures & fittings		2,047	682,563	52,551	309,331
	February	Heated towel hangers	578		683,141		
		Internal light fittings	1,426		684,567		
		Furniture items		7,728	692,295		
		Fittings	5,674		697,969		
		Floor work	5,930		703,899	81,164	390,495
	March	Additional works	37,312		741,211		
		Various works	29,603		770,814		
		Work on garage	5,284		776,098		
		Replacement of hedges		7,168	783,266		
		Telephones etc		4,904	788,170		
		Various furnishings		3,571	791,741		
		New stair rods		1,806	793,547		
		Removal of furniture packing		770	794,317		
		Repairs/ purchase of furniture		5,784	800,101		
		Repairs/ purchase of furniture		6,769	806,870		
		Blinds & bed linen		1,064	807,934	269,192	659,687
	April	Various works, Roof repairs	122,186		930,120		
		Various works	11,330		941,450		
		Chairs, fabrics, dishes		1,930	943,380	205,209	864,896
	May	Doorbell, video, plasterwork	5,169		948,549	8,831	873,727
	June	Fitting, repairing, painting	3,742		952,291	1,714	875,441
	July	Various works	49,188		1,001,479		
		Dampness repairs	7,006		1,008,485		
		Electric canopy		2,936	1,011,421		
		Garden lights	8,009		1,019,430		
		Bedroom carpet		1,085	1,020,515	116,684	992,125
	August				1,020,515	30,879	1,023,004
	September				1,020,515	1,554	1,024,558
	October				1,020,515		1,024,558
	November	Various maintenance	24,736		1,045,251	Note: Expenditure data analysed by Internal Audit only through mid- October 2010	
		Small household items		1,183	1,046,434		
		Fire extinguishers		796	1,047,230		
		Seating plan holder		240	1,047,470		
	December	Lights for garden	2,446		1,049,916		
2011	January	Final payment to contractor	2,323		1,052,239		
TOTALS			776,465	275,774	1,052,239	1,024,558	1,024,558

\*\*\* Note 1: Actual expenditure includes €25,700 for temporary accommodation for the Ambassador, which was sanctioned at a daily rate only, and is not included in the total of €1,020,515 sanctioned through October 2010

#### 4.4.2. Procurement Process and Compliance

##### Main Contractor

The selection of a contractor to carry out the original painting work at a cost of €24,000 is evidenced as being based on a tender process in June 2009 among three bidders, with the winning contractor being the locally recommended company, "AG Painter".

Major increases in the scope of the contracting work in November/December saw this original contract grow to some €450,000 by December 2009, without any re-tendering for the much larger scope to seek a more competitive bid.

In relation to this, we were informed that:

"The original project (interior walls and floors) began at the beginning of November 2009. During the early stages of the project the extent of the works necessary had not been uncovered and could not have been predicted and the attic had not been inspected at that time. Thus, the contractor was well into dealing with the basement damp problem, for example, when, months later, the attic problem was identified. It would not have been possible to divide up all the elements of the works, new and some major problems having emerged over time, among different contractors, nor would it have been practical... ... As the increasingly detailed project... proceeded, following analysis and under instruction from HQ, expert advice was given to HQ at all points from the contractor; the further problems were at every step identified, reported to the Embassy, translated and sent to HQ for analysis and sanction if appropriate. HQ expressed satisfaction at all points with the efficiency of the contractor on the basis of good assessments, good submissions, and good recommendations. From the commencement of the works in November 2009, Mark McSwiney also visited Prague on 3 occasions for inspection purposes and extensive coordination meetings with the contractors and any other involved subcontractors."

We have noted from internal correspondence that in November/December 2009 there was an urgency to finalise the contract additions and make advance payments to the contractor to match a budget that was still available for that year.

When the roof issue referred to above was identified, in March 2010 a process was actually undertaken where quotes were obtained from the existing contractor and two others. The "AG Painter" price was lower than the other two, and the roof repair contract was awarded on this basis.

From the compliance point of view, for structural works in 2009, Directive 2004/18/EU required that only contracts of greater than €5.2 million be advertised in the Official Journal of the EU and a competitive tendering process be carried out. However, from the business point of view, in our opinion it is possible that re-tendering in late 2009 for the then much larger scope would have achieved a more competitive bid.

## **Interior Furnishings and Fittings**

These were supplied by the Dutch company “Ruys Interiors” at an original cost of €186,000. With some extras added later, total payments to Ruys Interiors were €219,000.

According to the sanctioning correspondence from the Architectural Services Unit, the Ruys proposal was referred by them to the OPW, who indicated that its price was reasonable and recommended acceptance. On this basis, sanction for the Ruys expenditure was given.

There was no tendering process carried out for the supply of these items. From the business point of view, it seems very unlikely that best value would be achieved by dealing with one foreign supplier alone in this way.

From the compliance point of view, this represents a significant exception. In 2009, Directive 2004/18/EU required that contracts of greater than €135,000 (equivalent to €160,000 incl VAT in this case) for such goods and services be advertised in the Official Journal of the EU and a competitive tendering process be carried out. Not complying with the Directive exposed the Department to legal action.

Furthermore, Circular 40/02 of the Department of Finance requires that contracts over €25,000 that are to be awarded without a competitive process should be independently reviewed within a Department. This was not done. The Circular also requires that the Accounting Officer submits an Annual Report to the Office of the Comptroller and Auditor General in respect of such contracts awarded without a tender process. We understand from the Department that the Ruys transaction was not included in this report for 2009 or 2010.

### **4.4.3. On-Site Project Management**

It is normal practice that a local independent architect is appointed by the Department to:

- Assist in the definition of requirements
- Oversee and manage the day-to-day progress of the contract work
- Certify the satisfactory completion of the contractor’s work prior to payment of the contractor’s invoices.

### **Definition of Requirements**

We believe that had the usual policy to appoint an on-site expert to identify and evaluate the entire requirements been followed once the scope of work began to increase significantly (i.e. September/October 2009), this could have identified the major issues with the entire building and avoided the eventual piecemeal approach that occurred. This may well have been a cheaper approach, and would have provided greater on-site management of the project.

For example, in February 2010, when sanctioned expenditure had already reached €700,000, the Director of Architectural Services visited the attic space and saw indications of moisture penetration. Following this, a specialist hired by the contractor confirmed serious damp problems which resulted in the roof being removed in stages, the main wooden structure treated, and the wood supporting the roof tiling and most of the metalwork flashings being replaced. A waterproof membrane was installed between the new rafters and the dormer roof was insulated.

## Project Management

To have had an on-site project manager would also have considerably eased the pressure on the Embassy staff, who were heavily involved in the day-to-day project management. We were informed that the Embassy's role was to liaise between the contractors concerned and HQ, to conduct routine meetings with the contractors on foot of guidelines from HQ and to report on these in detail to HQ, and to maintain routine overview of progress between the three visits to Prague by the Director of Architectural Services in the course of the project.

## Verification of Invoices

The contractor's invoices were paid by the Prague mission without independent professional certification of the completion and quality of work done on each invoice. (However it is fair to also note here that there is no suggestion that any part of the contractor's work has been unsatisfactory).

### 4.4.4. Exceptions in Accounting for/ Recovery of VAT

#### Contractor Invoices

The contractor incorrectly invoiced VAT on several invoices, for example where advance payments were invoiced VAT was not charged, but was credited on final invoices when work was complete. For example:

##### Per AG Painter Invoice 120100004

	Excl VAT	VAT	Incl VAT
Invoice	3,776,135	541,272	4,317,409
Less already paid	(1,940,367)	(174,633)	(2,115,000)
Payable	1,835,768	366,639	2,202,409

##### This invoice should have shown:

	Excl VAT	VAT	Incl VAT
Invoice	3,776,135	541,272	4,317,407
Less already paid **	(2,115,000)	0	(2,115,000)
Payable	1,661,135	541,272	2,202,407

\*\* Per AG Painter Invoice 220090016, which did not charge VAT

VAT underinvoiced	Czech Koruna	174,633
	Euro equiv	7,250

Invoice 120100004, which shows VAT incorrectly, is the invoice booked to the financial system. Had the total of this invoice been used to recover VAT from the Czech revenue, this would have caused an under-recovery of VAT by the Department.

We are informed that the Embassy has identified all the cases of incorrect VAT and has recovered the correct amounts in every case. We did not extend our work to verify this.

## **Ruys Interiors Invoices**

Ruys invoiced Dutch VAT at 19% on its invoices. This VAT, about €35,000, has not been recovered. This VAT should not have been payable, or should be recoverable.

Our view is that as these were export sales from the Netherlands, the invoices should not have included VAT. We understand that Ruys were contacted about this by the mission, but refused to invoice without VAT.

## **Recommendations**

We recommend that the following approach be considered regarding Ruys:

- Obtain the correct interpretation of the Dutch regulations
- Agree these with Ruys, which should then issue a credit note for the total invoiced
- Ruys reinvoice the nett amount, and refund the €35,000 VAT to the Department
- Ruys recover this amount through its next VAT return to the Dutch revenue.

## **4.5. Addis Ababa Chancery Construction**

The project to transfer to a newly built chancery building in Addis Ababa originated in 2004 with an instalment payment for a long lease on a property.

Following this, completion of the lease acquisition was done in 2007, a tender process to select a contractor was carried out in late 2008, construction began in mid-2009 and the building was handed over in September 2010.

Given the more difficult construction environment in a country such as Ethiopia, the delivery of a building constructed to specification and without any significant additions to the construction contract, is a very successful outcome. This indicates that the construction project has been well managed. A full-time professional contract management company provided effective planning and on-site oversight of the work, and this was supported by regular site visits from a professional architect from the Department's Architectural Services Unit.

From our review, we consider the project files to have been well-maintained. Also, all documentation required by the audit was readily available.

The contract management company cost €130,000 over the course of the contract, about 5% of the total costs. Using this resource is likely to have been a good value-for-money decision.

### **4.5.1. Authorisation of the Project**

The decision to pay the original deposit of €200,000 for the leasehold property in 2004 from Vote 29 was made by the Development Cooperation Division without being authorised by the Secretary General. At that time the Architectural Services Unit had no role in the accommodation expenditures of Vote 29 and decisions were made by DCD.

The major authorisation steps in the project in 2007-2009 were appropriately given by the Secretary General.

However, the successive project cost estimates on which these authorisations were given were incomplete, as follows:

November 2007: Authorisation to pay €200,000 balance of site leasehold purchase and to proceed to design. Construction costs estimated at €800,000; total development costs estimated at €1.2 million (i.e. including site leasehold €400,000). This estimate could be regarded as incomplete as it did not reflect scoping the work to a European construction standard.

November 2008: Authorisation to tender for contractor. Construction costs were now estimated at €1.85 million. However, the estimate could not be considered complete since it excluded fees.

March 2009: Authorisation to proceed with construction. Overall capital cost excluding fees and VAT forecast to be €2.25 million (Contractor €1.843 million; site €400,000) and hence stated to be well below the 15:1 build/rent benchmark in use at that time. This could also be regarded as incomplete as it did not include fees, furnishings and fit-out costs, which later added some €450,000 to the total cost.

The final cost of the project was €2.704 million, excluding VAT. The main contractor's costs were successfully managed and brought in within €20,000 of the original tender price. The fees, furnishings and fit-out costs that were excluded from the March 2009 calculation accounted for the balance of the final cost.

The final total of €2,704 million is just within the 15:1 build/rent benchmark (€2,704,000 / €184,000 = 14.7), but this is only achieved by assuming an annual rental that is 50% higher than €115,000 that was being paid on the previous premises. However we have been informed that this has been the recent trend for suitable properties in Addis Ababa.

#### 4.5.2. Accounting for/ Tracking of Project Costs

##### Financial System

In the financial system, the Subhead accounting of the project expenditures appears unorthodox and is inconsistent with that of Vote 28.

The total cost of the project was split between Vote 28 and 29, and several subheads within Vote 29, as follows:

Addis Ababa Chancery				
Accounting for Costs				
Vote	Subhead	VAT-exclusive € million	VAT-inclusive € million	%
29	A3	0.182	0.397	14%
29	A4	0.005	0.005	0%
29	A5	0.022	0.022	1%
29	A6	2.146	2.146	74%
28	A6	0.312	0.312	11%
Paid through 2010		2.666	2.881	100%
Payable in 2011		0.038	0.038	
Projected Final Cost		2.704	2.919	

The basis of accounting for VAT under Vote 29 is to charge it to Subhead A3 "Incidental expenses". This totalled €215,000 for the project. While we comment elsewhere in this report on alternative methods of accounting for VAT, currently the accounting policies are inconsistent in Votes 28 and 29.

Also, up to 6th July 2009, professional fees for the project had been charged to A6, but as of this date much of the project-to-date professional fees were transferred from A6 to A3, and after this date all professional fees were charged to A3. The total fees expensed to A3 for the entire project was some €200,000, which was not accounted for as a capital cost in Vote 29.

##### Recommendation

As the Appropriation Account description of Subhead A6 is "Office premises expenses", it seems clear that all construction-related costs should be charged to this. Professional fees and VAT incurred as part of a capital project are part of the capital cost.



## **Project Accounting & Management Information**

In common with all other projects reviewed, because of the absence of project-based reporting from the financial system, the Mission had to track the project costs locally using off-line spreadsheets.

This has, as elsewhere, caused significant diversion of local management resources. As an example, as part of our audit, we wished to establish and verify the total cost of the project. Over two months elapsed (January 20th – March 29th) between the first steps in reconciling the project costs shown by the financial system to the cost analyses maintained in Addis Ababa, the latter being the basis for management's control over project costs. While some of this delay was unavoidable due to staff holidays etc., it illustrates the degree to which scarce mission-level resources are diverted by the need to maintain separate off-line records to provide project cost tracking for management use.

The final analysis compiled at the mission puts the final cost at €2.7 million exclusive of VAT. We have tied this closely to the general ledger analysis that we have carried out. We note, however, that a final cost of this order, being inclusive of all fees and other costs, had not appeared in any internal reports of the project outcome.

## APPENDIX Management Responses to Recommendations

The audit recommendations that are made throughout this report are summarised in the table below, with the responses of management to each.

Report Issue	Audit Recommendations	Management Response
<p>2.1. A Strengthened Role for the Architectural Services Unit</p>	<p>We recommend a strengthened role for the Architectural Services Unit in the identification and prioritisation of all refurbishment and maintenance projects.</p> <p>A previous report under the former Expenditure Review Initiative recommended a 7-year cycle of visits to all locations to assess accommodation and maintenance needs. We believe that it is necessary to go beyond this requirement. A structured programme of on-site expert architectural assessments, agreed by the MAC subcommittee, should be completed as soon as possible, as an important part of the prioritisation of projects to be funded from the much-reduced budget for the foreseeable future.</p> <p>These assessments should in the first instance focus on locations where:</p> <ul style="list-style-type: none"> <li>• Such visits have not been carried out recently</li> <li>• Local management have indicated construction, repair or maintenance issues that they consider to be urgent</li> <li>• The Architectural Services Unit is otherwise aware of issues, but needs better detail of scope</li> <li>• Others have identified significant issues (e.g. during inspections).</li> </ul> <p>The Architectural Services Unit recommendations arising from these reviews should be a key basis for the strengthened project authorisation and scheduling process recommended in this report, designed to ensure as far as possible that essential works are identified and prioritised, and non-essential work does not proceed.</p>	<p>Agreed. We will build on current practices, subject to the availability of staff resources.</p> <p>Agreed. We will initiate a regular cycle of visits to all overseas missions to assess accommodation and maintenance. Where possible, such visits will be incorporated into the regular round of Inspection visits.</p> <p>In the meantime, Missions are already required to return annual profiles in respect of all premises owned or rented abroad and to indicate, in that context, any construction, repair or maintenance issues that they consider to require attention.</p> <p>In addition, local management can, and does, raise other needs as they arise and significant issues may also be identified in the DFAT programme of Inspection Visits.</p> <p>Drawing on this information and its own familiarity with the Department's premises portfolio, supplemented as necessary by personal site visits, the Architectural Services Unit prepares a list of proposed projects reflecting its assessment of relative needs having regard to the budgetary resources available. These are then discussed with the Secretary General and the Head of Corporate Services and general priorities are identified. Within these parameters, individual projects may then be authorised on the basis of specific costed proposals.</p> <p>Other needs which may, and do, emerge during the year are similarly dealt with on the basis of written proposals</p>

Report Issue	Audit Recommendations	Management Response
		<p>submitted to the Secretary General via the Head of Corporate Services.</p> <p>Such oversight will henceforth be exercised by a Sub-Committee of the MAC (see point 2.2)</p>
<p>2.2. A Central Subcommittee to oversee all Project Activity</p>	<p>We recommend that a formal MAC Subcommittee should be established:</p> <ul style="list-style-type: none"> <li>• Chaired by the Secretary General</li> <li>• With 2 other members, the Head of Corporate Services and another senior MAC member with ambassadorial experience</li> <li>• All meetings being attended by the Head of Architectural Services, and the Head of Finance</li> <li>• With a designated officer from the Finance Unit to provide cost reporting of projects and respond to the needs of the Subcommittee and the Architectural Services Unit for analysis of project costs.</li> </ul> <p>The role of this Subcommittee would be:</p> <p><u>Project Scheduling</u></p> <ul style="list-style-type: none"> <li>• Oversee and approve the prioritisation of all projects as recommended by the Head of Architectural Services</li> <li>• Responsibility for the inclusion/ exclusion of projects where the Architectural Services Unit is unable to reach consensus with the missions involved</li> <li>• Revisit the project schedule quarterly, agreeing as required which projects to add and which to remove from the schedule</li> </ul> <p><u>Project Authorisation</u></p> <ul style="list-style-type: none"> <li>• Review and authorise the project scope and budgeted cost for projects over a certain value (e.g. €100,000) <ul style="list-style-type: none"> <li>◦ Below this value may be authorised by the Head of Corporate Services (e.g. over €25,000)</li> <li>◦ Under this value authorised by the Director of Architectural Services alone</li> </ul> </li> </ul>	<p>Recommendation accepted and is being implemented. A MAC Sub Committee has been established, chaired by the Secretary General and consisting of three, rather than two, other MAC members. As recommended, the Director of Architectural Services and Head of Finance will both attend all meetings.</p> <p>The Financial Management System (FMS) has the capacity to generate cost reporting of projects. The Finance Unit will be tasked to provide such assistance as Architectural Services, as the "Project Owner", may require for analysis and interpretation of costs and budgets.</p> <p>The Sub Committee will assume, with a broader membership and some enhancements in remit, the role currently played by the Secretary General, Head of Corporate Services and Director of Architectural Services in relation to Project Scheduling and Authorisation.</p> <p>As the recommendation acknowledges, scheduling needs to continue to be sufficiently flexible to allow for adjustments in response to unforeseen circumstances and changing priorities.</p> <p>At present, the approval of the Secretary General is normally sought for projects exceeding €25,000. The proposed delegation of authority to the Head of Corporate Services would, in fact, be greater than that which currently applies in practice.</p>

Report Issue	Audit Recommendations	Management Response
	<ul style="list-style-type: none"> <li>• Authorise the delegation of all project budgets to missions throughout the year</li> <li>• Review and re-authorise the project scope and budgeted cost for projects where a cost overrun is forecast (e.g. overrun against original budget of 10%+)</li> <li>• Under this limit, overruns authorised by the Director of Architectural Services alone</li> </ul> <p><u>Procurement</u></p> <ul style="list-style-type: none"> <li>• Define authority limits for the selection of contractors and suppliers</li> <li>• Receive evidence of, and approve, the selection process for all individual contracts or purchase orders over a certain value (e.g. €50,000)</li> </ul> <p><u>Monitoring of Project Progress &amp; Costs</u></p> <ul style="list-style-type: none"> <li>• Be informed by the Director of Architectural Services on the operational progress of projects</li> <li>• Review quarterly financial reports of project costs, overall and for major projects</li> <li>• Query cost trends and forecasts</li> <li>• Revisit individual project scope and schedules as necessary in response to cost overruns</li> </ul> <p><u>Other Issues</u></p> <ul style="list-style-type: none"> <li>• Be informed by the Director of Architectural Services of other relevant issues</li> <li>• Monitor the progress of the renegotiation of leases</li> <li>• Initiate high level decisions on sale of properties etc.</li> </ul>	<p>Response on the proposed <b>Delegation of all project budgets to Missions</b> is provided at 2.3 below.</p> <p>Recommendation accepted in principle. As far as possible the thresholds should be aligned with general procurement thresholds of "Over 25,000" and Over €100,000" (as detailed on the Department's intranet).</p> <p>Response on <b>leases</b> provided at 3.1</p> <p>It is considered that it would be better for the Committee to periodically review the property portfolio and authorise, rather than initiate, sales.</p>

Report Issue	Audit Recommendations	Management Response
<p>2.3. Decentralised Budgeting for all Subhead A6 Expenditures</p>	<p>We recommend that ownership and accountability for expenditure, and hence value for money, will be improved by decentralising the project-related A6 budget to the missions. This will be in addition to the non-project budget that is already allocated to missions, the latter covering rentals, energy, minor maintenance, etc.</p> <p>This will allow visibility of project costs at local level, which is currently not available. It will also deliver central efficiencies within the Architectural Services Unit; for example the payment sanction process can be discontinued, freeing resources for more value-added functions as recommended throughout this report.</p> <p>The process for allocating the project element of the A6 budget across the missions will be the key element in this, supported by the much improved management reporting described below.</p> <p>The annual budget for project expenditure would be allocated as follows:</p> <ul style="list-style-type: none"> <li>• At the start of the year to each mission for the forecasted remaining costs on projects already in progress</li> <li>• The balance of the annual budget being held at the centre pending approval of new projects</li> <li>• As new projects are approved during the year, the project budgets are then allocated to the missions involved and deducted from the balance remaining at the centre.</li> </ul>	<p>While it is accepted that greater visibility of projects costs at local level is desirable and practical steps should be taken in that direction, the Department does not propose to go so far as to decentralise all project budgets to Missions as recommended.</p> <p>As observed in Paragraph 1.3 of the Report, Diplomatic Officers and local Mission staff generally may not have the experience or expertise to deal with the project-related issues that may arise.</p> <p>Moreover, implementation of a delegated approach carries a risk of inflexibilities with scarce capital in danger of being tied to particular projects which may for genuine operational reasons become delayed. By holding funding at the centre at HQ, which is in a position to form an overview of the relative progress of projects in train, it is much easier to balance the respective needs in various locations and switch funds between projects as necessary.</p> <p>Accordingly, it is considered that Architectural Services Unit should retain responsibility for management of the A6 budget, within the parameters approved by the MAC Sub Committee and subject to its oversight. The Head of Mission, as sub-accounting officer, should continue to ensure that the individual components of all payments from the official account conform to relevant sanctions.</p> <p>It is fully accepted that there is scope for greater efficiencies in tracking project expenditure at Missions and reconciling payments with sanctions issued and the recommendations of the Internal Audit Report are helpful in that regard.</p>

Report Issue	Audit Recommendations	Management Response
<p><b>2.4. Strengthened Role for the Finance Function and Improved Financial Management and Accounting Support</b></p>	<p>The issues that have been identified in this report with regard to weaknesses in project budgeting and forecasting, inadequate financial and management reporting, failure to fully recover VAT/sales taxes by missions (see Sections on Ottawa and The Hague projects), point to the need to considerably strengthen the Department's Finance function. The Finance function should play an important role in ensuring that a sound internal control framework is in place.</p> <p>The Department's Audit Committee has noted the very limited number of professionally qualified accountants employed in finance roles, with none at key decision-making levels. The Audit Committee has expressed its concern with this situation given the pressures on budgets and the need for heightened financial control and efficient use of resources. The Committee has recommended that the Head of Finance should be a professional accountant at Counsellor/ Principal Officer grade with significant relevant experience, and that this position be supported by qualified accountants with financial/ management accounting roles for each Vote.</p> <p>We believe the issues raised and the recommendations made in this report strongly support the Audit Committee's recommendation, in that the Finance Unit would need to provide for:</p> <ul style="list-style-type: none"> <li>• Greater use of decentralised budgets and ongoing allocation to missions</li> <li>• The needs of the MAC Subcommittee in overseeing project activity, for: <ul style="list-style-type: none"> <li>◦ Timely cost reporting against project and annual budgets</li> <li>◦ Analysis and challenge of projected costs</li> <li>◦ Assurance that contract costs are not exceeded</li> <li>◦ "Early warning" of project costs that may exceed budget</li> </ul> </li> <li>• Regular and ad-hoc project data tailored to the needs of central and mission-level management.</li> </ul>	<p>It is assumed that the strengthened role envisaged for the Finance Unit is of an oversight and support nature and that it is not envisaged that it would amount to a fundamental change in the way that the Department manages its budgets, whereby primary responsibility for project budgeting, forecasting and management is vested in the budget holders responsible.</p> <p>The Department will seek the sanction of the Department of Public Expenditure and Reform to recruit a professionally qualified Chief Financial Officer. It is intended that the CFO will head a fully integrated Department Finance Unit, covering Votes 27 and 28.</p> <p>Sanction was secured this year from the Department of Public Expenditure and Reform for the recruitment of two Professional Accountants (Grade 1; AP equivalent) – one through public service redeployment and the other via open public competition.</p> <p>Response on decentralised budgets at 2.3 above refers.</p>
<p><b>2.5. Improved Management Reporting</b></p>	<p>The proposed MAC Subcommittee, the budget holders and the Architectural Services Unit, need much enhanced management reporting. This must be regularly available on a project-by-project basis.</p>	

Report Issue	Audit Recommendations	Management Response
	<p>We believe that the Finance Unit should set up and maintain quality and prompt project cost reporting, i.e. regular reporting to senior management and quarterly to the MAC Subcommittee on project costs and forecast final costs, with budget comparisons (specific format shown in paragraph 2.5). The staff carrying this out must have the authority and competence to work proactively with the senior staff at the missions and with the Architectural Services Unit.</p> <p>This summary report will be derived from individual project reports (specific format shown in paragraph 2.5) showing the delegated budget for each separate project. These ideally to be produced monthly. These are intended primarily for use by the missions as budget holder for the project, and form the basis for discussions between the designated Finance officer and the missions regarding the continued accuracy of projected costs.</p> <p>We recommend that the capacities of Finance Unit staff to generate ad-hoc financial reports from the financial management system be increased. It is essential that management can readily seek analyses of data to support reviews of expenditure, by making use of the coding structures set up to benchmark costs of maintenance, energy, security, rentals, etc. and allow constructive cost comparisons across missions.</p>	<p>On the basis that responsibility for project management and budgets remains with the project owners, the Finance Unit will work with the project owners to capture more data and develop more comprehensive reports. This approach will be applied to all significant projects within the Department.</p> <p>A summary report will be independently produced by the Finance Unit, as far as possible using the format proposed.</p> <p>The capacity to generate ad hoc reports from the FMS exists where the data has been captured and this will be utilised.</p>
<p>2.6. Appoint Dedicated Project Personnel to Major Projects</p>	<p>While it is generally the practice to appoint a local firm of architects to act as Project Manager, we recommend that consideration be given, on a project-specific and cost/benefit basis, to the temporary deployment of an experienced person to be temporarily appointed to a mission that is commencing a major or complex project. Such a Project Manager could be based in Dublin should there not be a need for a full-time post at the mission concerned, and could be assigned responsibility for more than one project if feasible.</p> <p>The objective of this additional staffing is to relieve the mission staff (who will otherwise face significantly increased responsibilities in areas where they are likely to have no prior experience) by:</p> <ul style="list-style-type: none"> <li>• Acting as the primary point of contact between the local architect/ project manager, contractors and senior mission staff</li> <li>• Attending at site meetings and dealing with local authorities, neighbours,</li> </ul>	<p>The need to appoint Project Managers where warranted by the scale of the project is accepted.</p> <p>Key elements of the role envisaged would require familiarity with the local environment, including planning laws and other relevant regulations, and possibly also linguistic proficiency in non-Anglophone locations.</p> <p>On that assumption, while the source of such appointments could be considered on a case-by-case basis, it is considered that a temporary externally-sourced project manager with local expertise would normally be the most practicable and cost-effective of the options suggested.</p>

Report Issue	Audit Recommendations	Management Response
	<p>etc.</p> <ul style="list-style-type: none"> <li>Assuring the validity of payments to contractors</li> <li>Liaising with the Head of Mission, the Architectural Services Unit, the MAC Subcommittee, and the central Finance Unit as recommended in this report.</li> </ul> <p>Elsewhere in the Department, or in the wider Public Service, there may be officers who already have this experience, or who may be better equipped to carry out these functions than the existing mission staff. Alternatively, it may be possible to source a Project Manager externally on a temporary basis with the requisite qualifications, experience and skills.</p>	<p>With steeply declining permanent staffing numbers, any prospect of releasing core Departmental officers with the necessary expertise from other priority duties has considerably diminished.</p> <p>The Department will explore the practicability of the suggestion that officers might be available elsewhere in the public service with the necessary expertise and experience to perform this function. This would depend also on whether the officers concerned would be personally willing to undertake short-term overseas assignments and releasable on that basis by their parent Departments or Offices.</p>



Report Issue	Audit Recommendations	Management Response
2.7. Further Development of Policies and Procedures	<p>We recommend that the standards contained in The Department's "Green Book" should be updated by the Coordination and Compliance Unit, with support as necessary from the Architectural Services Unit, to reflect management's current expectations and changes in technology as necessary.</p> <p>Additional subject material should be added in the premises management area, for example:</p> <ul style="list-style-type: none"> <li>• Procurement policies, procedures and documentation</li> <li>• Local IT infrastructure security, continuity and contingency planning</li> <li>• Data security</li> <li>• Premises fixed security – e.g. updated standards for access/layout, locks, alarms, detectors etc. <ul style="list-style-type: none"> <li>◦ response to non-malicious incidents – fire etc.</li> <li>◦ response to malicious incidents – break-ins, vandalism, suspicious packages etc.</li> <li>◦ response to major incidents – evacuation etc.</li> </ul> </li> <li>• Security regarding people – e.g. use of guards, vetting of contractors etc coming onto the premises.</li> </ul> <p>Specifically in respect of renovation projects, recognition should be given to the methodologies in the Department of Finance 2010 "Capital Works Management Framework". While in many cases designed for larger projects, this includes:</p> <ul style="list-style-type: none"> <li>• Standard forms of construction contracts and associated model forms, dispute resolution rules, model invitations to tender, forms of tender and schedules</li> <li>• Standard conditions of engagement for consultants, dispute resolution rules, model invitations to tender, forms of tender and schedules</li> <li>• Standard templates to record cost planning and control information, and for suitability assessment</li> <li>• Guidance notes covering the various activities in a project delivery process.</li> </ul> <p>The review of standards should also address inclusion of the Department's</p>	<p>As far as can be ascertained the "Green Book" was developed in 1993/94 and has in most cases been overtaken by resources available on the Department's intranet. This is considered to be a more practical and dynamic way of ensuring that guidance and procedures are kept up to date and readily accessible to all officers.</p> <p>Extensive material on public procurement policies, materials, resources, contracts and frameworks as well as forms and templates are already posted on the intranet. If specific gaps are identified, the Department is prepared to address these.</p> <p>Extensive and robust ICT security policies are in place. These are being consolidated in a comprehensive ICT Security Policy which will be finalised shortly and should be circulated in Q1 2013.</p> <p>The Department will review, and to the degree necessary enhance, its use of these methodologies in renovation projects where they may be applicable to the scale of the projects in question and the local operating environments in which they are being undertaken.</p>

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	<p>“Standard Terms of Business” in accommodation-related contracts, making mandatory appropriate clauses regarding indemnification, confidentiality, and compliance with both local laws and the relevant EU regulations as to appropriateness of bidders.</p> <p>Specifically regarding rented residential properties, a policy should be developed and disseminated that requires increases in rent and any other costs at all residential accommodation to be justified and authorised in writing. Based on the amount involved (i.e. the gross amount of additional rental or other costs to be spent) this should be authorised in accordance with the authorisation levels recommended for capital/ maintenance projects in this report.</p>	<p>Established practice essentially accords with the thrust of this recommendation. The terms of all leases for office or residential premises, including rent review clauses, have to be expressly approved by Corporate Services Division. All renewals have to be similarly sanctioned. Heads of Mission have standing instructions, in that context, to investigate whether a move to more economical premises would be more viable and cost-effective.</p>
<p>3.1. Management of Overseas Property Lease Renewals</p>	<p>We recommend that the Architectural Services Unit should have a more proactive role in the renewal of leases, to include all of the following:</p> <ul style="list-style-type: none"> <li>• Formally notify missions of upcoming lease expiry, at least 12 months in advance</li> <li>• Liaise with missions to ensure that there are realistic options available in good time before the existing landlord is approached to negotiate renewal terms, e.g. <ul style="list-style-type: none"> <li>○ Assess the viable alternatives available, e.g. renew or move elsewhere</li> <li>○ Employ local expertise on the rental market.</li> </ul> </li> </ul> <p>We also recommend that the central lease record be enhanced to provide all the management information that is required to benchmark rental costs and to support a proactive role in managing renewals, i.e. as set out in paragraph 3.1 of the report detail above.</p> <p>The Architectural Services Unit should upskill staff as required to manage the database software used.</p>	<p>Architectural Services has long been proactive in relation to lease management and has engaged with Missions over a number of years with a view to containing, and where possible reducing, costs of rented property.</p> <p>Heads of Mission have standing instructions, reiterated in start of year budgetary communications</p> <ul style="list-style-type: none"> <li>• to renegotiate downwards rent levels in existing leased premises where possible</li> <li>• in the perspective of forthcoming expiry of leases, to rigorously review the suitability of present accommodation having regard to the State’s diminished budgetary capacity having regard to the State’s diminished budgetary capacity.</li> <li>• assess whether more favourable terms can be negotiated on the present premises or</li> <li>• if it would be more cost-effective to source new accommodation, taking account of the attendant relocation costs.</li> </ul>

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		<p>These initiatives have led to significant savings in rental costs and some relocations.</p> <p>The central lease register already contains extensive lease management information and can be enhanced further in light of the recommendations of this report.</p>
<p>3.2.3. Issues regarding VAT and Sales Taxes</p>	<p><b>Seek an Up-Front Exemption</b></p> <p>The ideal solution is to obtain a VAT/sales tax exemption that would enable invoices to be zero-rated. This means that the VAT is not paid out and no further work is required. We acknowledge that these arrangements are agreed on a reciprocal basis, but nevertheless recommend that the possibility of obtaining a VAT exemption that provides for zero-rating of suppliers invoices, should be followed up with the local Revenue authorities by other missions, where relevant.</p> <p><b>Account on an Accruals Basis; Mission-Level Budget Responsibility</b></p> <p>Where exemption cannot be obtained, the way to have proper visibility across the organisation of the recovery of these taxes is to account for these in the missions' general ledgers on an accruals basis, as happens in private sector organisations that are registered for VAT. In this methodology:</p> <ul style="list-style-type: none"> <li>• Invoices would be coded to charge the expense subhead with the net amount</li> <li>• A balance sheet account at each mission would be charged with the tax on each invoice</li> <li>• This balance sheet account would be credited with the periodic refunds received from the local Revenue</li> <li>• The balance on this account will then transparently show the amount of taxes unrefunded.</li> </ul> <p>To report monthly costs on a cash basis, the balance on the balance sheet account must be expensed. For simplicity, this could be charged in one amount to a single subhead. This will distort the costs on this subhead somewhat, though only to a small degree if tax refunds are received in a timely way. There could be a single year-end exercise to allocate the balance across the correct subheads, if material</p>	<p>As acknowledged in the report, tax exemption arrangements are agreed on a reciprocal basis. Nevertheless, the Department will ask Missions to review local VAT arrangements.</p> <p>Even where VAT refunds are possible and claimed, local tax authorities can be tardy in processing claims and may have a degree of discretion in relation to the elements that may be allowed.</p> <p>This recommendation will require further detailed consideration. The proposed system would add to the complexity of local accounting in terms of mixing net and gross payments. It will also demand greater administration to reconcile those refunds disallowed or not received within the current year.</p> <p>A system that distorts costs in particular subheads would seem problematic given that experience with local tax authorities indicates that the timely recovery on which it relies cannot be presumed upon.</p>

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	<p>unrecovered amounts are involved.</p> <p>Alternatively, VAT recoverable should be a budget line item for missions. The amounts recoverable are as "budgetable" as the costs to which they relate.</p> <p>Either methodology should be a practical and effective method of providing a consistent accounting policy across the two Votes, ensuring adequate visibility for the tax recovery process at each mission, and allowing periodic central review by the Finance Unit to ensure that the Department-wide policy is being addressed in a timely way.</p> <p><b>Establish a Consistent Way of Tracking Recoveries at Local Level</b></p> <p>Individual monthly claims and recoveries must be managed at local level. There is no substitute for a detailed local checking process that matches the individual transactions claimed to those refunded. Where there are discrepancies, these must be immediately followed up.</p> <p><b>Nett Recovered VAT and Sales Taxes against Subhead Costs</b></p> <p>The method recommended above of charging the nett amount of the invoice against the subhead, achieves the objective of stating costs more fairly, nett of taxes recovered.</p> <p><b>Role of the Finance Unit</b></p> <p>The Finance Unit should play a more visible role in monitoring the accounting for and recovery of VAT/sales taxes by missions and ensuring that the balances not recovered at the year-end are minimised.</p>	<p>This might represent a more practicable approach although given the various rates of VAT applying to different areas of expenditure, it may be difficult for Missions to accurately estimate their VAT "budget".</p> <p>Accepted. As part of the preparation of the Appropriation Accounts, similar controls are in place in respect of bank account balances at year-end as well as pre-payments.</p>
<p><b>4.4.4. Exceptions in Accounting for/ Recovery of VAT</b></p>	<p><u>Ruys Interiors Invoices (Prague Furnishings)</u></p> <p>Ruys invoiced Dutch VAT at 19% on its invoices. This VAT, about €35,000, has not been recovered. This VAT should not have been payable, or should be recoverable.</p>	<p>The matter will be pursued on the basis of the recommended approach.</p>

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	<p>Our view is that as these were export sales from the Netherlands, the invoices should not have included VAT. We understand that Ruys were contacted about this by the mission, but refused to invoice without VAT.</p> <p>We recommend that the following approach be considered regarding Ruys:</p> <ul style="list-style-type: none"> <li>• Obtain the correct interpretation of the Dutch regulations</li> <li>• Agree these with Ruys, which should then issue a credit note for the total invoiced</li> <li>• Ruys reinvoice the nett amount, and refund the €35,000 VAT to the Department</li> <li>• Ruys recover this amount through its next VAT return to the Dutch Revenue.</li> </ul>	
<p>4.5.2. Accounting for VAT on Project Costs (Vote 27 - DCD)</p>	<p>The basis of accounting for VAT (in relation to construction projects) under Vote 29 (now Vote 27) is to charge it to Subhead A3 "Incidental expenses". While we comment elsewhere in this report on alternative methods of accounting for VAT, currently the accounting policies are inconsistent in Votes 28 and 29 (27).</p> <p>As the Appropriation Account description of Subhead A6 is "Office premises expenses", it seems clear that all construction-related costs should be charged to this. Professional fees and VAT incurred as part of a capital project are part of the capital cost.</p>	<p>Accepted.</p>
<p>3.3. Inter-Vote Cost Recharges</p>	<p>To maintain the formality of an accurate charge to both Votes, we recommend that the basis of the charge be recalculated to reflect the costs of the Limerick and Hatch Street offices now occupied.</p>	<p>Agreed. This would entail not so much a recalculation as a review of the different elements involved and their bases of calculation. Evaluation and Audit Unit might most appropriately carry out the review.</p>
<p>3.5. Custody and Recordkeeping of Artworks</p>	<p>We make the following recommendations:</p> <ul style="list-style-type: none"> <li>• The register should be set up on a mission-by-mission format (for both Votes)</li> <li>• It should be a photographic record</li> <li>• The latest version should be matched to the 2008 version and exceptions should be followed up</li> <li>• Each mission should be given a copy of its part of the register, identifying the</li> </ul>	<p>These recommendations largely reflect and are congruent with improvements identified by Architectural Services Unit in discussions in the course of this review.</p>

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	<p>most significant items, so that senior mission staff can:</p> <ul style="list-style-type: none"> <li>○ Be aware of the relative value of items in their custody</li> <li>○ Decide on appropriately secure locations within the Chancery/Residence buildings</li> <li>○ Verify continuing existence and condition on an ongoing basis</li> </ul> <ul style="list-style-type: none"> <li>• An annual return should be put in place where the Head of Mission confirms that all items in the register are present and that the register is complete for the mission</li> <li>• A process for independent verification of items on hand should be set up (e.g. in conjunction with routine visits by the Architectural Services Unit, Inspection Department, Internal Audit, etc.).</li> </ul> <p>Because this process will provide the missions with a local mission-based register that will be auditable, it will be reasonable to expect them to respond promptly with photos and descriptions of their items on hand.</p> <p>In parallel to this, the provenance issue should be addressed, at least for the major owned works in the collection.</p>	
3.6. Custody and Recordkeeping of Inventories	<p>We recommend that the central monitoring of mission inventories be discontinued.</p> <p>Instead, we recommend that the missions carry out regular local verification of existence of higher-value and more "portable" items, e.g. crystal, official china, cutlery, table linens, etc. Locally, the results of these counts should be assessed against senior mission staff's own knowledge of what quantities should be on hand.</p> <p>Otherwise, larger items such as furniture, carpets, etc. should be recorded on a photographic register of each room's contents, and confirmation of continued existence be incorporated into the process recommended for artworks above, i.e.:</p> <ul style="list-style-type: none"> <li>• An annual return where the Head of Mission confirms that all furniture items in their photographic register are present and that the register is complete for their mission</li> <li>• A process for occasional independent verification of items on hand (e.g. in</li> </ul>	<p>The recommendation to discontinue central monitoring of inventories is agreed.</p> <p>However, management would question the reliability of the proposed alternative system of local counts "assessed against senior Mission staff's own knowledge of what quantities should be on hand" as it is not felt that this could be regarded as an objective criterion. It is considered that the existing standard list of items supplied to the average Mission could more usefully be employed as a benchmark or point of reference. It is also considered that Heads of Mission on arrival and departure from a post should sign off on inventories locally which would subsequently be available for independent verification as suggested in the recommendation.</p>

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	routine visits by the Architectural Services Unit, Inspection function, Internal Audit etc.).	The Architectural Services and Finance Units are currently collaborating on how best to resolving the issue of recording items of value in the context of the Department's asset policy.

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